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99th Congress
2d Session

COMMITTEE PRINT

COMMITTEE ON THE BUDGET
U.S. HOUSE OF REPRESENTATIVES

PRESIDENT REAGAN'S FISCAL YEAR 1987 BUDGET

[A Summary and Analysis Prepared by the Staff of the House Budget Committee]

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THE BUDGET TOTALS

As Proposed by the Administration

(In Billions of Dollars)

Fiscal Year 1985 (Actual)

Budget Authority	1,074.05
Outlays	946.30
Revenues	734.05
Deficit	212.25

Fiscal Year 1986 (Proposed)

Budget Authority	1,058.75
Outlays	979.95
Revenues	777.15
Deficit	202.80

Fiscal Year 1987 (Proposed)

Budget Authority	1,102.00
Outlays	994.00
Revenues	850.35
Deficit	143.65

Fiscal Year 1988 (Proposed)

Budget Authority	1,165.95
Outlays	1,026.75
Revenues	933.20
Deficit	93.55

Fiscal Year 1989 (Proposed)

Budget Authority	1,218.05
Outlays	1,063.60
Revenues	996.10
Deficit	67.50

Fiscal Year 1990 (Proposed)

Budget Authority	1,261.30
Outlays	1,093.85
Revenues	1,058.10
Deficit	35.75

Fiscal Year 1991 (Proposed)

Budget Authority	1,310.10
Outlays	1,122.70
Revenues	1,124.05
Deficit	-1.35

I. PRIORITIES IN PRESIDENT REAGAN'S BUDGET FOR FISCAL YEAR 1987

A. President Reagan's Budget Plan

	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991
Budget Authority.....	1102.0	1165.9	1218.0	1261.3	1310.1
Outlays.....	994.0	1026.8	1063.6	1093.8	1122.7
Revenues.....	850.4	933.2	996.1	1058.1	1124.0
Deficit.....	-143.6	-93.6	-67.5	-35.8	+1.3

The effect of 1986 sequestration is reflected in the President's budget totals.

THE BALANCED BUDGET AND EMERGENCY DEFICIT CONTROL ACT OF 1985 (Gramm-Rudman)

The Act requires the President to submit a budget which does not exceed the maximum deficit amount (MDA) for the applicable fiscal year. Further, Congressional budget resolutions must also be within the maximum deficit amount of the applicable fiscal year.

Under Gramm-Rudman the maximum deficit amount for fiscal year 1987 is $144.0 billion. According to the administration, the President's budget request for fiscal year 1987, if implemented, would result in a deficit of $143.6 billion, in other words, below the Gramm-Rudman maximum deficit amount. However, initial estimates by the House Budget Committee staff indicate that the administration has underestimated Pentagon spending by as much as $4 billion in fiscal year 1986, as much as $15 billion in 1987 and as much as $50-60 billion for the period 1986-1991. In addition, interest costs are substantially underestimated in later years. **If these initial staff estimates prove correct, the President's budget request would not be in compliance with the deficit provisions of Gramm-Rudman.**

SUMMARY OF THE PRESIDENT'S BUDGET

The overall theme of the 1987 budget is a continuation of the last five years --- increased Pentagon spending and reduced domestic spending. The budget would reduce the President's projected "current services" deficits by $38 billion in 1987, $56 billion in 1988 and $71 billion in 1989. These reductions would be achieved in non-Pentagon spending by terminating programs, reducing programs, selling Federal assets, transferring programs to state and local governments, imposing or expanding user fees and cutting or "reforming" various program and management costs.

SPENDING POLICY

Defense

The President's budget proposes what the administration calls a "modest increase" in Pentagon spending and requests a budget authority level of $320 billion. The budget refers to this as a three percent increase in real growth.

The administration's description of the request understates the true increase in military spending requested for 1987. When compared to what the Pentagon has been provided in 1986, the President's request amounts to an increase of $34 billion in budget authority or a nominal increase of 12 percent and a real increase of 8.3 percent. (The President's budget understates the size of the increase because in stating the growth rate it ignores the 1986 reductions required by Gramm-Rudman. In addition, initial estimates indicate that the administration has understated its projected outlays for the Pentagon by as much as $4 billion in fiscal year 1986, $15 billion in fiscal year 1987 and $50-60 billion for the period 1986-1991.)

The practical effect of the President's request for 1987 is to restore the aggregate military program reduction mandated by Gramm-Rudman in 1986 and not count this restoration as an increase over 1986.

Domestic Programs (Excluding Social Security)

The President's budget proposes changes in domestic programs for fiscal year 1987 that would result in outlay reductions of about $21 billion as compared to 1986 levels and about $27 billion as compared to the "current services" baseline projection. (In addition, the budget proposes to rescind almost $10 billion in previously appropriated budget authority.)

Between 1987 and 1991 these policy changes would reduce spending by about $264 billion compared to the current services baseline. These cuts would be achieved through:

- Program Terminations -- The President's budget proposes to terminate 40 programs which are viewed as "ineffective, duplicative or unnecessary". Major proposals include: eliminating Revenue Sharing, Ex-Im Bank direct loans, SBA loans, EDA, ARC, UDAG, WIN, Legal Services, mass transit section 3 discretionary capital grants and Washington Metro grants, Postal subsidy, Amtrak subsidy, State Maritime schools, the recent expansion of cargo preference, Title XI loan guarantees for ship construction and the new GI bill test program.

- Program and Management "Reforms" -- The President's budget proposes various savings in social programs including medicare, student aid, school lunches, medicaid, AFDC, veterans medical care, refugee assistance, health professions training subsidies, Indian health care, summer youth employment, Job Corps and biomedical research grants. Additional savings are assumed from the improved management of Federal operations.

- Privatization -- To reduce "competition with the private sector" the President's budget proposes to sell assets to the private sector or terminate Federal subsidies. Major proposals include: restricting eligibility for FHA mortgage insurance, replacing direct assistance with housing and education vouchers, selling the Naval petroleum reserves and Power marketing administrations.

- Federalism -- The budget proposes to transfer certain activities to state and local governments through block grants. Other grants that are not viewed as a Federal responsibility will be terminated or reduced. Examples include a new block grant for local ground transportation which result in significant reductions or elimination of certain existing highway and mass transit programs; a block grant for pollution control; phasing out assistance for sewage treatment plants and terminating community services block grants.

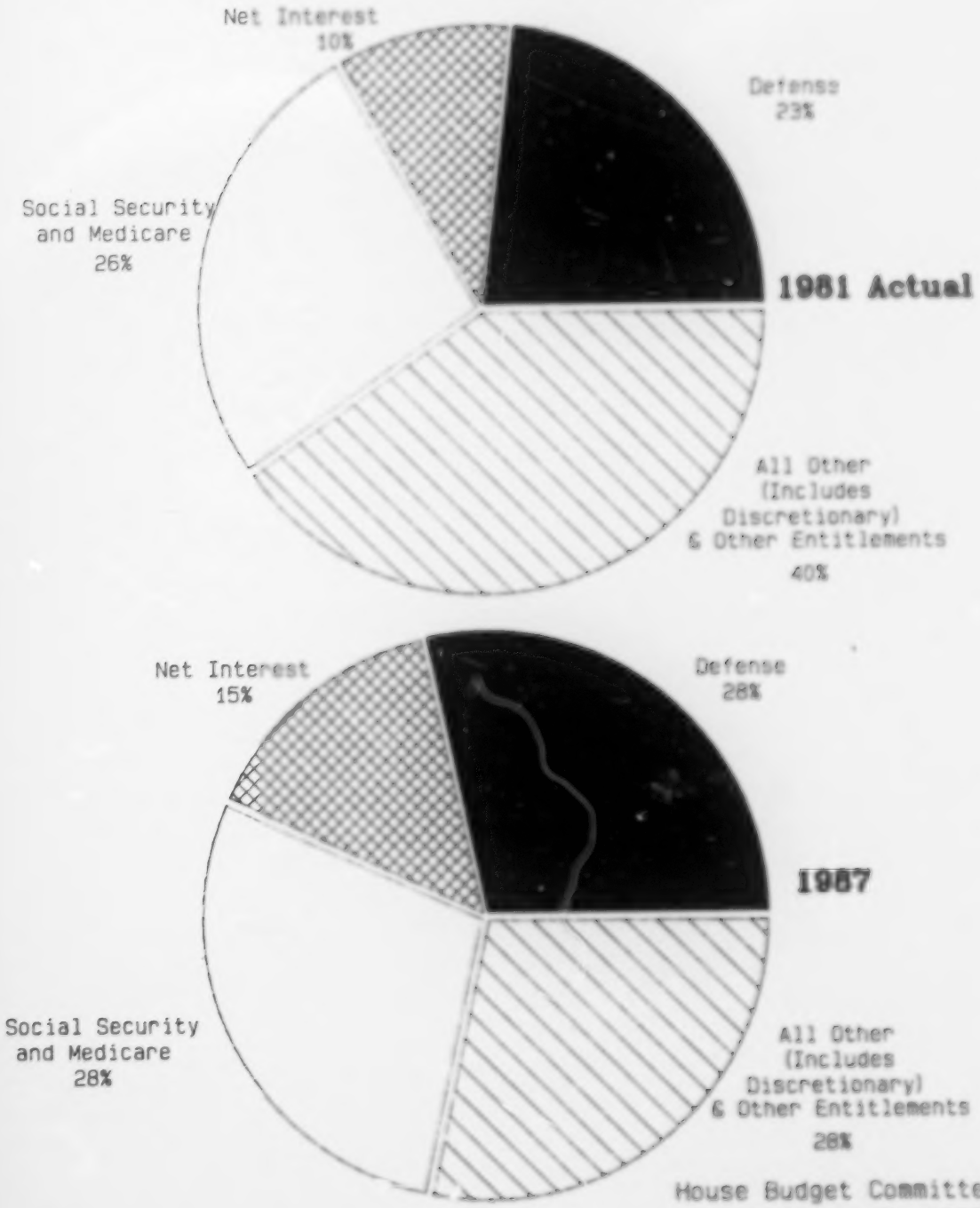
- Charges for Government Services -- The budget proposes a number of new or expanded user fees, including: increased fees for recreation facilities and waterways and new fees for meat and poultry inspection.

REVENUE PROPOSALS

The President's budget proposes a large number of minor tax increases but no increase in major taxes, so that revenues remain at 19 percent or slightly less of GNP in fiscal years 1986 to 1989. The net revenue increase in fiscal year 1987 is $6.3 billion over current law revenues of $844.1 billion in fiscal year 1987.

The President's budget renews previous proposals for tax preferences for higher education savings accounts and private school tuition tax credits. These tax losses are more than offset by increases in a variety of narrow-base or special purpose taxes and fees. Many of these proposals are repeated from past budgets and a number of them are included in the Conference Report on the Omnibus Reconciliation Act of 1985 (H.R. 3128). The largest 1987 revenue raisers are extension of the current temporary 16 cent cigarette tax, an increase in Federal employee and District of Columbia contributions toward retirement, assignment of oil price overchanges to the Federal Government, Internal Revenue Service fees, penalties and stepped up collection efforts, and acceleration of state payroll tax deposits.

PRESIDENT'S PRIORITIES 1987 COMPARED TO 1981
(Outlays in Billions of Dollars)



House Budget Committee
February 5, 1986

B. The Revised Congressional Budget Process

Significant substantive and procedural changes have been adopted affecting the manner in which the Congress responds to the President's budgetary proposals. The changes result from the enactment of the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings). The major changes are:

(1) The President's budget must be in conformance with the deficit targets set forth in Gramm-Rudman. For fiscal year 1987, the deficit target is $144 billion. The President's budget, as submitted, has a deficit of $143.6 billion.

(2) The budget resolution must also be in conformance with the deficit targets set forth in Gramm-Rudman, regardless of whatever rearrangement of spending and/or revenue priorities the Congress may adopt. This provision could, however, be waived by a majority vote in the case of the Committee reported resolution or a 3/5 vote in the case of a conference report on a concurrent resolution on the budget.

(3) April 15 is the new target date for Congress to complete action on the annual budget resolution. (There is no reporting date for the resolution in the House; the Senate has a target date of April 1 for reporting). The spending and revenue levels are binding upon adoption in both bodies.

(4) The Committee report on the budget resolution must include 302(a) allocations (prior law only required them at conference report stage).

(5) February 25 is the new date for committees to submit their views and estimates to the Budget Committee. (Previously referred to as the "March 15" reports.)

(6) Appropriation bills may be considered in the House after May 15, even if Congress has yet to adopt a budget resolution.

(7) The May 15 reporting deadline for authorizing legislation is repealed.

(8) All appropriation bills must be reported in the House by June 10 and passed by the House before the July 4 recess (reconciliation bills must be passed by the House also).

In addition, the Balanced Budget and Emergency Deficit Control Act of 1985 affects the budgetary treatment of Social Security trust funds for fiscal years 1986 through 1992. Pursuant to section 261(a)(1)(E) of the Act, the receipts and disbursements of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund may not be included in the totals of the budget of the United States Government as submitted by the President.

However, it should also be noted that the receipts and disbursements of the trust funds are included in the Federal budget for fiscal years 1986 through 1991 for the purposes of the deficit estimates required to determine whether the Federal deficit is within the maximum deficit amount targets required by the new law.

The Balanced Budget and Emergency Deficit Control Act of 1985 requires that all previously off-budget Federal spending activities are now part of the unified budget, except for the treatment of Social Security, as noted above. Section 214 of the Act sets forth this requirement. Section 201(a)(1) defines "off-budget Federal entity" as "any entity (other than a privately-owned Government-sponsored entity)--

(A) which is established by federal law, and
(B) the receipts and disbursements of which are required by law to be excluded from the totals of --
    (i) the budget of the United States Government submitted by the President pursuant to section 1105 of title 31, United Code, or
    (ii) the budget adopted by the Congress pursuant to title III of this Act."

In the event that Congress fails to adopt policies, signed by the President, that conform to the deficit target in any fiscal year, spending reductions would be made automatically pursuant to sequestration procedures set out in the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings). Sequestration would also occur if the economic and spendout estimates used in formulating the budget proved too optimistic, even if Congress did enact the planned policy reductions. The higher deficit would still trigger sequestration.

A discussion of Gramm-Rudman law is available as a Budget Committee print.

C. Deficits and Debt: Historical Perspective

The Federal deficits incurred in the 1980s have done serious damage to the economy, causing record trade deficits which have been a drag on growth and unbalanced the economy. Even if Gramm-Rudman target deficits are achieved in future years, the policies of the 1980s will have permanently raised the national debt and the interest payments that eventually must be shouldered by American taxpayers.

A discussion of fiscal policy and the economy is found in the sections that follow. This section presents some historical data on budget deficits and public debt, using the administration's estimates.

Total Deficits Ranked by Size

Even if Gramm-Rudman targets are met, the administration will have presided over the seven largest deficits in history.

Rank	Fiscal Year	Deficit	Administration
1	1985	212.3	Reagan
2	1983	207.8	Reagan
3	1986*	202.8	Reagan
4	1984	185.3	Reagan
5	1987*	143.6	Reagan
6	1982	127.9	Reagan
7	1988*	93.6	Reagan
8	1981	78.9	Carter
9	1980	73.8	Carter
10	1976	73.7	Ford

*Proposed in President's 1987 budget.

The size of the economy has grown significantly over the years, and the administration's analysis appropriately measures the deficit in relation to Gross National Product (GNP). By this standard, the World War II era far surpasses any other; the fiscal year 1943 deficit reached 31 percent of GNP. Since World War II, however, the 10 largest deficits as a percent of GNP are:

Total Deficits as a Percentage of GNP Since 1948 Ranked by Size

Rank	Fiscal Year	Deficit	Administration
1	1983	6.3	Reagan
2	1985	5.4	Reagan
3	1984	5.0	Reagan
4	1986*	4.8	Reagan
5	1976	4.3	Ford
6	1982	4.1	Reagan
7	1975	3.5	Nixon
8	1987*	3.2	Reagan
9	1968	3.0	Johnson
10	1977	2.8	Ford

*Proposed in President's 1987 budget.

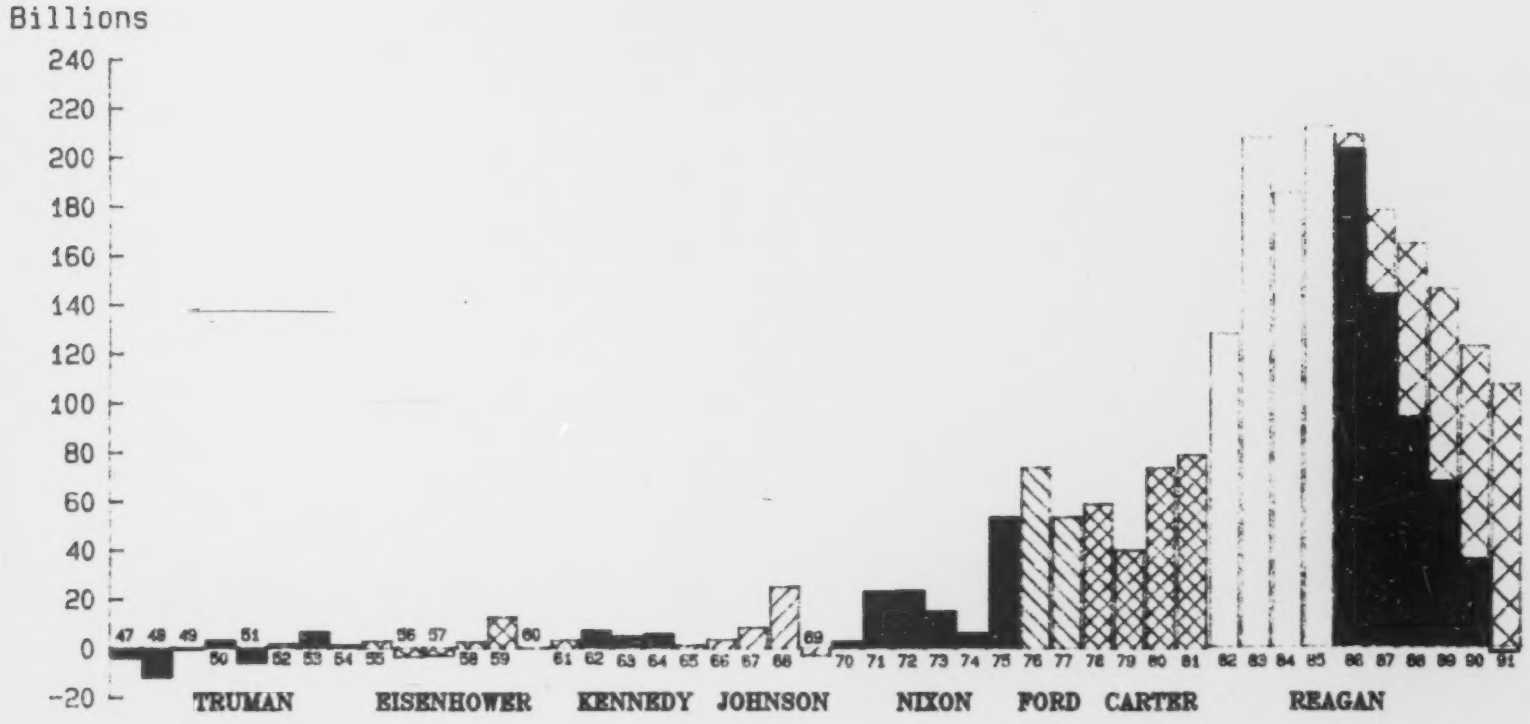
By the end of the current fiscal year, both the total national debt (debt subject to limit) and the economically more significant debt held by the public will have doubled in the five years since the beginning of fiscal year 1982.

Increase in Federal Debt
(Fiscal years, $ billions)

	Increase in national debt (debt subject to limit)	Increase in debt held by the public
1789 to 1981 (192 years).....	998.8	794.4
1982 to 1986 (5 years).....	1109.7	919.6

Again, the size of the economy has changed significantly over time. As it grows, the capacity of the credit markets to absorb Federal debt increases. Measuring debt as a percentage of Gross National Product (GNP) reveals significant trends, however. World War II produced a massive debt as a percent of GNP. Since then, the debt held by the public decreased substantially as a percent of GNP, to a low point of 24 percent in 1974. It fluctuated slightly in 1974 to 1981, never exceeding 29 percent, but has increased rapidly since 1981 to 41 percent in 1986. In Part II, the debt relative to GNP is charted under current baseline projections.

HISTORICAL DEFICITS
1947–1991
(In billions of dollars)



President's Proposed Deficits to meet Gramm-Rudman requirements

CBO Preliminary Baseline Deficit Projections

House Budget Committee
February 5, 1986

II. FISCAL POLICY

A. Summary

- The administration projects that its budget proposals will reduce the Federal deficit (including those funds that are currently off-budget) from $203 billion in the current fiscal year to $144 billion in fiscal year 1987, $68 billion in fiscal year 1989, and a surplus of $1 billion in fiscal year 1991. The administration recommends deep cuts in nondefense spending, increases in military spending, and a number of minor tax increases.

- Under somewhat less optimistic estimating assumptions, the administration's proposals would lead to somewhat higher deficits but the structural deficit -- the deficit estimated at a constant unemployment rate of 6 percent -- would still decline rapidly.

- The sharp rise in the deficit since fiscal year 1981 is not the result of uncontrolled domestic spending. Rather, it results from a long-term erosion of general (non-payroll tax) revenues and 1981 policy changes of large tax cuts and an acceleration of defense spending, which also drove up interest costs.

- The main adverse effect of large deficits to date has been felt in industries exposed to international trade as exporters or competitors with imports. The merchandise trade deficit has risen from $36.4 billion in 1980 to $148.5 billion in 1985.

- By relying on borrowing from abroad to finance its large Federal deficits and rising credit demands, the U.S. is about to become the world's largest debtor nation. Our international debt is projected to rise extremely rapidly during the late 1980s. Servicing this debt will reduce U.S. living standards in the future.

- The increase in the deficit has sharply reduced our nation's saving. When the foreign lending to the U.S. slows, as it eventually will, there is a danger that domestic investment will be stifled by high interest rates, thereby reducing capital formation and economic growth.

- The rise in Federal deficits and debt since 1981 has doubled the burden of interest payments on future taxpayers. Even if deficits are reduced in the future, this interest burden will remain as a legacy of the 1980s.

- "Privatization" of Federal activities and sales of Federal assets will not achieve either permanent deficit reduction or meaningful fiscal policy restraint. The "privatization" issue concerns the role of government and should not be obscured by budgetary considerations.

- The Gramm-Rudman deficit target of $144 billion in 1987 requires a sharp increase in fiscal restraint. It is uncertain whether monetary policy will be adjusted in a timely manner to support continued economic expansion in these circumstances.

B. Administration Projections and Policy Proposals

On December 11 Congress passed and on December 12 the President signed the "Balanced Budget and Emergency Deficit Control Act of 1985," commonly known as Gramm-Rudman. The Act sets a declining path of "maximum deficit amounts" from $171.9 billion in fiscal year 1986 to $0 in 1991 as shown in Part D of Table 1. If the deficit target is not met in a given fiscal year, a mandatory "sequestration" process is triggered, forcing automatic across-the-board spending cuts in those parts of the budget not exempted in the Act.

The administration's current services projection of the total (on- and off-budget) deficit (Table 1, Part A) falls steadily from $205.6 billion in fiscal year 1986 to $181.8 billion in 1987 and $103.9 billion in 1991. Under the administration proposals these current services deficits would be reduced by $38.2 billion in 1987, by $71.4 billion in 1989, and by $105.2 billion by 1991. Specific deficit reductions for 1987 (Table 1, Part B) include revenue increases of $6.3 billion, and spending reductions from this administration baseline of $2.7 billion in defense and $27.3 billion in nondefense. Projected deficits under the administration's proposal (Table 1, Part C) are $143.6 billion in 1987, $67.5 billion in 1989 and a surplus of $1.3 billion in 1991.

Does the President's Budget Meet the Gramm-Rudman Deficit Targets?

The administration's projections show the deficit reaching the Gramm-Rudman deficit targets in 1987-1991 under the policies proposed by the President. However, there are a number of problems with the administration's projections.

- Defense spending. It appears likely that the administration's proposed defense budget authority would lead to a significantly higher rate of spending than the administration has projected. House Budget Committee staff estimates that the President's defense outlays are underestimated by $3-$5 billion in 1986, by $12-$15 billion in each year of 1987-89, and by $6-$8 billion in each year of 1990-91.

- Economic growth. The administration continues to forecast real growth at 4 percent per year over the next three years; actual growth last year was only 2.5 percent. If growth is closer to 3 percent but inflation is higher than the administration projects, as currently forecast by the average of three major commercial services, revenues under administration policies could be $14-$16 billion lower in 1987 and $8-$12 billion lower by 1991.

- Interest rates. The administration's short-term interest rates are higher than the commercial services projections in the current year but over 2½ percentage points lower by 1991. Such an interest rate difference could add about $40 billion to the deficit by that year.

- Budget contingencies. The administration's budget projections do not allow for such contingencies as unusually low farm prices, which have caused very high farm price support spending in the current year, or the possibility of financial failures leading to high outlays by deposit insurance institutions. On the other hand, a

comparison of preliminary CBO and administration estimates suggests that there may also be some technical estimating differences that could tend to reduce the administration's deficit estimates in 1987, perhaps partly offsetting some of the defense and economic differences.

Taking these problems into account, in comparison with current private forecasts, the administration's deficit projection may be understated by $15 to $25 billion in fiscal year 1987 and $55 to $65 billion by fiscal year 1991. Although reestimates which reduce the projected deficits are, of course, possible, the risks are preponderantly that the projected deficits are too low and will later have to be raised. The implication is that the administration's projected deficits do not in reality meet the Gramm-Rudman targets.

Fiscal Policy Implications of President's Budget

The change in the "structural" deficit (discussed more fully in the next section) is the most commonly used measure of fiscal stimulus or restraint for the economy. Based on administration projections, HBC staff estimates that the structural deficit would be cut from 3.9 percent of GNP in 1985 to 2.4 percent in 1987. This reduction in the structural deficit of 1.5 percent of GNP is a large increase in fiscal restraint by historical standards. There is a serious question whether monetary policy can be adjusted in a timely way to sustain economc growth in the face of the sharp fiscal restraint.

Furthermore, if as argued above the administration assumptions are too optimistic, then the amount of fiscal restraint must be even greater than proposed by the administration to meet the Gramm-Rudman targets.

Table 1

Administration Budget Aggregates 1/
(Fiscal Years, $ billions)

	Actual		Projected					
	1981	1985	1986	1987	1988	1989	1990	1991
A. Administration Current Services								
Revenues	599.3	734.1	776.5	844.1	927.3	989.2	1053.0	1120.2
Outlays	678.2	946.3	982.0	1025.9	1077.3	1128.1	1179.3	1224.1
Deficit	78.9	212.3	205.6	181.8	150.0	138.9	126.3	103.9
B. Policy Changes in Administration Proposal								
Defense Spending Changes 2/	--	--	--	-2.7	-4.5	-6.3	-9.3	-13.1
Non-Defense Spending Reductions 3/	--	--	-2.1	-27.3	-41.2	-50.3	-65.5	-74.2
Revenue Increases (-)	--	--	-0.7	-6.3	-5.9	-6.9	-5.0	-3.9
Total Policy Deficit Reduction	--	--	-2.8	-36.3	-51.6	-63.5	-79.8	-91.2
Debt Service Savings 4/	--	--	--	-1.9	-4.8	-7.9	-10.7	-14.0
Total Deficit Reduction	--	--	-2.8	-38.2	-56.4	-71.4	-90.5	-105.2
C. Administration Proposal								
Revenues	599.3	734.1	777.1	850.4	933.2	996.1	1058.1	1124.0
Outlays	678.2	946.3	979.9	994.0	1026.8	1063.6	1093.8	1122.7
Deficit	78.9	212.3	202.8	143.6	93.6	67.5	35.8	-1.3*
D. Gramm-Rudman Deficit Targets								
Deficit Target			171.9	144	108	72	36	0

1/ Includes off-budget revenues and outlays.
2/ The administration current services spending base from which these reductions are calculated is the fiscal year 1986 Budget Resolution for 1987 and 1988, with 3 percent real growth in defense budget authority in 1989-91.
3/ Includes associated adjustments to offsetting interest receipts.
4/ Differs from "net interest policy change" as shown in administration budget tables, which includes, while this line excludes, reductions in Treasury interest receipts which partially offset spending reductions elsewhere in the budget.

* Budget Surplus.

Note: Detail may not add to totals due to rounding.

C. Preliminary Baseline Budget Projections

The preliminary CBO baseline budget projections shown in Table 2 have been prepared on CBO economic assumptions which are somewhat less optimistic than the administration's. This preliminary baseline differs from CBO baselines in previous years in three major respects:

1. The baseline assumes full implementation of the fiscal year 1986 Gramm-Rudman sequestration of $11.7 billion which goes into effect March 1, 1986. Consequently, in 1987-91 projected outlays will be lower than without 1986 sequestration due both to the reduction in 1986 budget authority and to lower 1987-91 budget authority and program levels.

2. The baseline assumes zero real growth in defense budget authority during 1987-91, measured off a 1986 post-sequestration budget authority base. This differs from the February and August 1985 CBO baselines, which assumed 5 percent real growth in defense budget authority, and from the fiscal year 1986 budget resolution which assumed zero real growth in 1986 and 3 percent real growth thereafter.

3. The baseline assumes significantly lower interest rates than previously. Because the declining deficit path under Gramm-Rudman is now law, it is assumed that these deficit targets will be met, thus reducing upward pressure on interest rates.

Deficits under this preliminary baseline fall steadily from $209 billion in 1986 to $178 billion in 1987 and $107 billion by 1991. As a share of GNP the deficit falls from 5.0 percent in 1985 to 4.0 percent in 1987 and 1.8 percent in 1991.

Table 2

Preliminary CBO Baseline Budget Projections 1/
(Fiscal Years, $ billions)

	Actual		Projected					
	1981	1985	1986	1987	1988	1989	1990	1991
Revenues	599.3	734.1	778	845	922	993	1070	1145
Outlays	678.2	946.3	987	1023	1087	1139	1192	1252
Total Deficit	78.9	212.3	209	178	164	146	123	107
Cyclical Deficit	43.5	52.4	47	42	36	25	13	0
"Structural" Deficit	35.4	159.9	162	136	128	121	110	107
			Percent of GNP					
Revenues	20.1	18.6	18.6	18.8	19.1	19.0	19.0	18.9
Outlays	22.7	24.0	23.5	22.7	22.5	21.8	21.2	20.7
Total Deficit	2.6	5.4	5.0	4.0	3.4	2.8	2.2	1.8
Cyclical Deficit	1.5	1.3	1.1	0.9	0.8	0.5	0.2	0.0
"Structural" Deficit*	1.1	3.9	3.8	2.9	2.6	2.3	1.9	1.7

*percent of potential GNP

1/ Includes off-budget revenues and outlays. Assumes zero real growth in defense, post-policy interest rates, and implementation of 1986 $11.7 billion sequestration effective March 1, 1986.

Note: Detail may not add to totals due to rounding.

The economic significance of the budget deficit is best understood when the deficit is separated into its cyclical and structural components. The "cyclical" deficit indicates how much of the deficit is associated with cyclical changes in economic activity; since tax revenues decline and outlays increase during a recession, the cyclical deficit rises in recessions and falls during recoveries. The "structural" deficit is the estimated deficit if the economy were operating at a constant 6 percent rate of unemployment. Change in the structural deficit is the most commonly used measure of fiscal stimulus or restraint for the economy.

When the deficit first rose sharply in 1982 and 1983 to over $200 billion, much of the increase was due to the 1981-82 recession. In 1982, $90 billion, or 70 percent, of the $127.9 billion deficit was cyclical, while only $38 billion was structural. As a share of potential GNP, the structural deficit was only 1.1 percent. In 1983, the cyclical deficit reached $112 billion, 54 percent of the $207.8 billion total deficit, while the structural deficit rose to $96 billion and 2.6 percent of potential GNP.

Since 1983, as the economy has recovered, the cyclical deficit has declined. However, this decline has been more than offset by dramatic increases in the structural deficit. By 1985, the cyclical deficit had fallen to $52 billion, or 25 percent of the deficit, while the structural deficit had grown to $160 billion and 3.9 percent of GNP.

A decline in the deficit along the path in the preliminary CBO baseline projections would involve reductions in both the cyclical and structural deficits, as shown in Figure 1. By 1991, if growth is sufficient to reduce the unemployment rate to 6 percent as projected, the cyclical deficit will be eliminated; the structural deficit would total $107 billion, down from $160 billion in 1985. In relation to the economy, the structural deficit in 1991 would be back down to pre-1983 levels, or 1.7 percent of potential GNP.

The declining deficit path under these preliminary baseline projections indicates a reversal of the fiscal pattern of large deficits -- both in absolute terms and in relation to GNP -- that has prevailed from 1982 through 1986. However, there are several reasons why these projections should be regarded with caution:

First, although this preliminary CBO baseline is less optimistic in its economic assumptions than the administration's projection, it nevertheless makes certain optimistic assumptions:

- It is based on the postwar average of growth over nine years from business cycle troughs. But productivity in the current recovery has been below the postwar average, so long-term real GNP growth may also turn out below average.

- It projects smooth growth for those nine years. Only one expansion in our history has lasted nine years uninterrupted by recession -- the 106 month 1961-69 expansion, which included the Vietnam War buildup. The average expansion since World War II has lasted less than four years.

- Large spending cuts or tax increases to achieve Gramm-Rudman targets could have a contractionary effect on the economy if not offset by easing of monetary policy, the implementation of which could involve serious problems of judgment and timing.

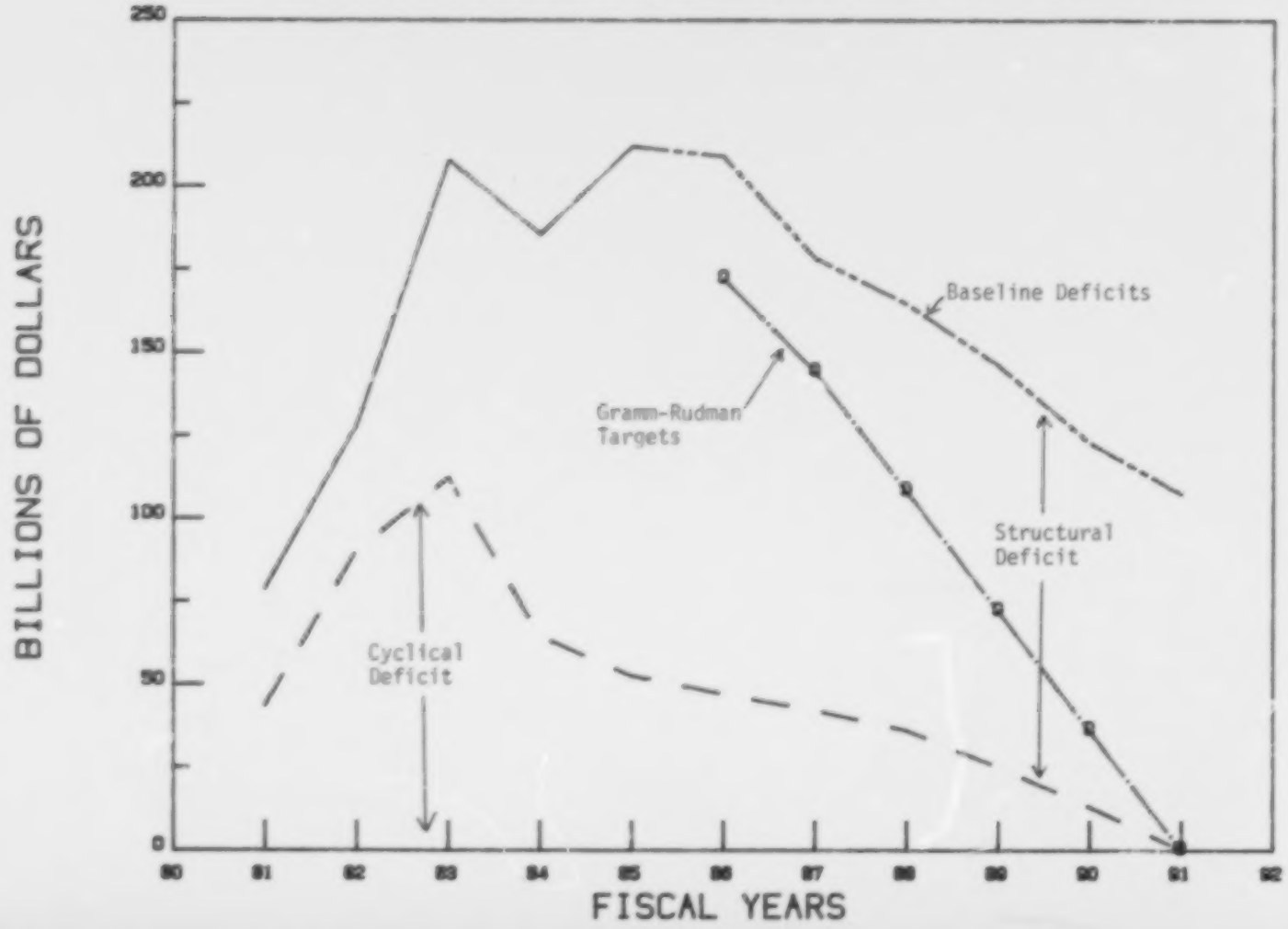
- If foreign capital inflows should threaten to decline rapidly, the Federal Reserve might find it necessary for interest rates to rise in order to maintain capital flows and combat the inflationary effect of dollar depreciation; this, too, involves a risk of slower growth or recession.

Second, since the President has proposed significant real growth in defense, military spending could rise above baseline levels, thus raising the deficit if offsetting actions are not taken.

Third, there is a danger that spending could run above the estimates for economic reasons unrelated to policy changes. Continued weakness in commodity prices could lead to higher costs for farm programs than projected, as happened in fiscal year 1986. Increasing instability in the financial sector -- which also is a result of falling commodity prices and has already created record bank and business failures -- could jeopardize the economic assumptions underlying the baseline, as well as raise budget outlays if larger payments are required from the deposit insurance systems.

Figure 1

ESTIMATE OF TOTAL DEFICITS UNDER PRELIMINARY BASELINE: CYCLICAL AND STRUCTURAL COMPONENTS



D. What's Driving the Deficit?

What has caused the recent massive increase in the deficit from $40 billion as recently as 1979 to over $200 billion in 1985 and 1986? This explosion in the deficit can be traced to two basic developments, one long-term and the other more recent.

First, there has been a continuous fall in "general revenues" (revenues excluding payroll taxes for Social Security and Medicare) relative to the economy for the past twenty-five years, and a sharp acceleration of this trend since 1981. This was due largely to several major corporate income tax reductions during the period, but also to an erosion of excise tax revenues as effective excise tax rates declined with inflation.

This fall in general revenues, with a corresponding rise in "general spending" (outlays exclusive of Social Security and Medicare) produced a gradual rise in the deficit of about 2½ percent of GNP during the 1960s and 1970s. However, there was no "deficit explosion," principally because the drop in general revenues during the 1970s was more than offset by a decline in defense spending relative to GNP after the Vietnam War.

The second development was the budget policy adopted in 1981. Clearly, the erosion in general revenues was sustainable without large deficits only so long as defense, or other large components of general spending, were declining. Defense spending, which had begun to rise in the late 1970s, was sharply accelerated in 1981. At the same time, however, rather than moving to restore general revenues to pay for rising defense, the new budget policy reduced general revenues even further through large individual and corporate tax cuts. This was done in the mistaken belief, or hope, that these tax cuts would miraculously raise revenues through historically unprecedented "supply-side" growth and/or that spending cuts elsewhere in the budget (often unspecified) or reductions in "waste, fraud and abuse" would keep the deficit from rising. When this did not happen, the deficit more than doubled as a share of GNP within several years, leaving the large deficits we face today.

Table 3
Long-term Budget Trends
(percent of GNP)

	1960	1970	1981	1986	1960-1986	1986 Impact of Change (1986 Dollars billions)
Total Budget						
Revenues	18.2	19.5	20.1	18.6	+0.3	+14
Outlays	18.2	19.8	22.7	23.5	+5.4	-226
Deficit (-)	+0.1	-0.3	-2.6	-5.0	-5.0	-211
Social Security and Medicare Budget						
Revenues	2.1	3.9	5.4	5.9	+3.8	+160
Outlays	2.3	3.7	6.0	5.9	+3.6	-153
Deficit (-)	-0.2	+0.2	-0.6	0.0	+0.2	+7
Remainder of Budget (excluding Social Security and Medicare)						
Revenues	16.1	15.6	14.7	12.6	-3.5	-146
Outlays	15.9	16.1	16.7	17.6	+1.7	-73
Deficit (-)	+0.2	-0.5	-2.0	-5.0	-5.2	-219

Note: Detail may not add to totals due to rounding.

Tables 3 and 4 illustrate these developments. Table 3 shows how the apparent long-term stability of total revenues at 18-19 percent of GNP masks two opposite trends -- a very sharp rise in payroll taxes and an almost equally sharp drop in general revenues in relation to GNP. The higher payroll taxes closely match the rise in spending on programs financed by them, leaving this component of the budget in balance. In the rest of the budget, however, the fall in general revenues and modest rise in general spending gradually raised the deficit by about 2½ percent of GNP during 1960-1981; in 1981-1986, however, the deficit explodes when both the revenue erosion and higher spending accelerate sharply.

Table 4 analyzes the 1981-1986 deficit increase for the total budget in more detail. From these data it is clear that the rise in government spending is not due to "uncontrolled domestic spending," as the administration has alleged. In fact, domestic spending has declined by a full 1.3 percent of GNP. The higher spending is attributable, in roughly equal shares, to two factors: the increase in military spending and the extremely rapid rise in interest costs to finance the large deficits.

Table 4
Change in Budget Structure and Size from 1981 to 1986
(Fiscal years, percent of GNP) 1/

	1981	1986 2/	Change 1981-1986	1986 Impact of 1981-1986 Change (1986 Dollars billions)
Outlays	22.7	23.5	+0.8	+35
Defense	5.3	6.4	+1.2	+48
Net Interest	2.3	3.3	+1.0	+41
Domestic	15.1	13.8	-1.3	-55
Revenues	20.1	18.6	-1.5	-64*
Deficit	2.6	5.0	+2.3	+98
Memorandum:				
Outlays				
Social Security/ Medicare	6.0	5.9	-0.1	-2
Other	16.7	17.6	+0.9	+37
Revenues				
Social Security/ Medicare	5.4	5.9	+0.5#	+22#
Other	14.7	12.6	-2.0*	-86*
Deficit				
Social Security/ Medicare	-0.6	0.0	-0.6	-24
Other	-2.0	-5.0	+2.9	+122

*revenue loss
#revenue increase

1/ Total Budget: includes off-budget revenues and outlays.
2/ Preliminary baseline estimates.
Note: Detail may not add to totals due to rounding.

The last column in Table 4 shows the impact on the 1986 budget of these changes in budget structure and size from 1981 to 1986. The budget deficit in 1986, at 5.0 percent of GNP, is projected to be $209 billion. Had it remained at the 2.6 percent of GNP of 1981, it would be only $111 billion, or $98 billion less. This $98 billion addition to the 1986 deficit can be attributed to structural changes as follows:

- Revenues have declined from 20.1 percent of GNP in 1981 to 18.6 percent in 1986, a drop of 1.5 percentage points; this accounts for $64 billion of the $98 billion.

- Outlays have increased from 22.7 percent of GNP in 1981 to 23.5 percent in 1986, a rise of 0.8 percentage points; this accounts for $35 billion.

- Within spending, defense spending has increased as a share of GNP by 1.2 percentage points, adding $48 billion to the deficit. Net interest payments have increased as a share of GNP by 1.0 percentage points, adding $41 billion.

- The reduction of domestic spending by 1.3 percent of GNP means that the deficit is $55 billion lower than it would have been had domestic spending kept pace with GNP in 1981-1986.

Domestic spending, then, is neither "uncontrolled" nor has it been the principal source of the increase in the deficit since 1981. Rather, these deficits have been driven by the rapid defense buildup, large revenue losses from tax cuts, and the resulting rising interest payments on the debt.

Table 4 also shows how the erosion of revenues other than those from Social Security and Medicare and general spending (principally on the military) accelerated during 1981-1986. The Social Security and Medicare accounts swung substantially out of deficit to balance during this period, while the rest of the budget plunged deeply into deficit.

E. Economic Effects of the Recent Increases in Deficits and Debt

Four years of high and rising budget deficits have taken their toll on the economy. Stimulative fiscal policy, in conjunction with an anti-inflationary monetary policy, has resulted in:

- a sharp deterioration in the trade balance
- severe imbalances in the domestic economy
- slower economic growth
- a rapid buildup in U.S. debt to foreigners

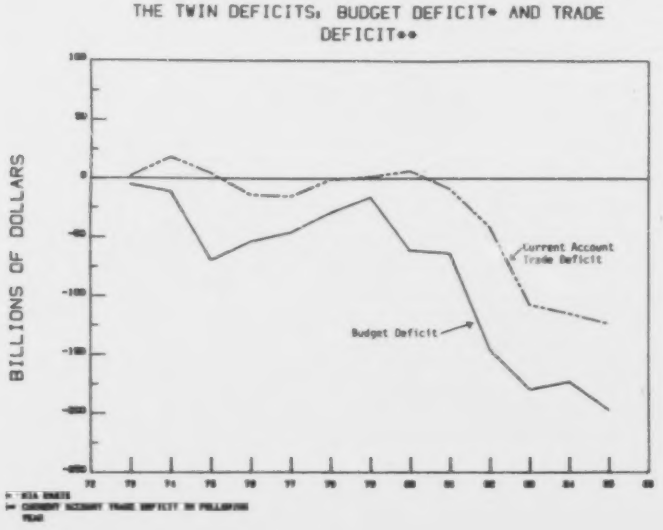
Some of these problems may not be painlessly eliminated as the budget deficit is reduced because they have become deeply entrenched. Jobs and markets have been permanently lost as companies have sourced cheaper parts and equipment abroad and have moved labor intensive and high volume production overseas. It is by no means clear that in the short run new activities that emerge will be good substitutes either in terms of income or location. The foreign debt we have amassed to support current consumption will have to be serviced, and perhaps repaid, by reversing this pattern and producing more than we consume, implying a reduction in future living standards.

The Twin Deficits

The budget deficit is linked to the trade deficit through its impact on interest rates and capital flows. The combination of an anti-inflationary monetary policy and the government's demand on credit markets to finance the deficit has put an upward pressure on interest rates which, in real terms, remain high relative to those in our past and to those abroad.

While these high rates may have slowed growth in credit-sensitive sectors such as housing, their chief impact has fallen on the trading sectors of the economy as these more attractive rates of return on U.S. assets have attracted large inflows of foreign capital and induced U.S. investors that would have otherwise placed their funds abroad to keep them at home.

Chart 2: Twin Deficits

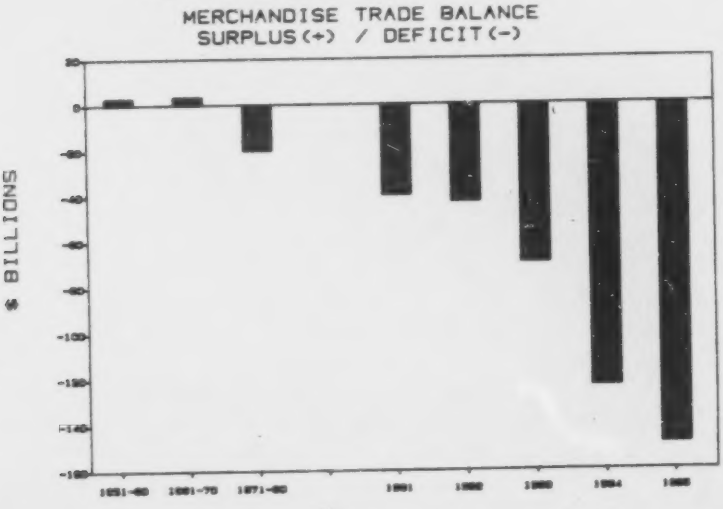


The resulting increase in the demand for dollars pushed up the value of the dollar sharply. Even after accounting for differences in inflation rates the dollar rose by more than 40 percent between the end of 1980 and its peak in early 1985. Since then the dollar has declined steadily, a trend reinforced by the agreement of the major industrial countries in September 1985 to intervene in foreign exchange markets to bring further decreases the value of the dollar. Since that time it has fallen about 10 percent against the currencies of our major trading partners.

Chart 3: Exchange Value of the Dollar

The sharp appreciation of the dollar during the past five years made U.S. exports expensive in world markets while imports became comparatively cheap in domestic markets. As a result our merchandise trade balance deteriorated sharply from $36 billion in 1980 to $148 billion in 1985.

Chart 4: Merchandise Trade Balance



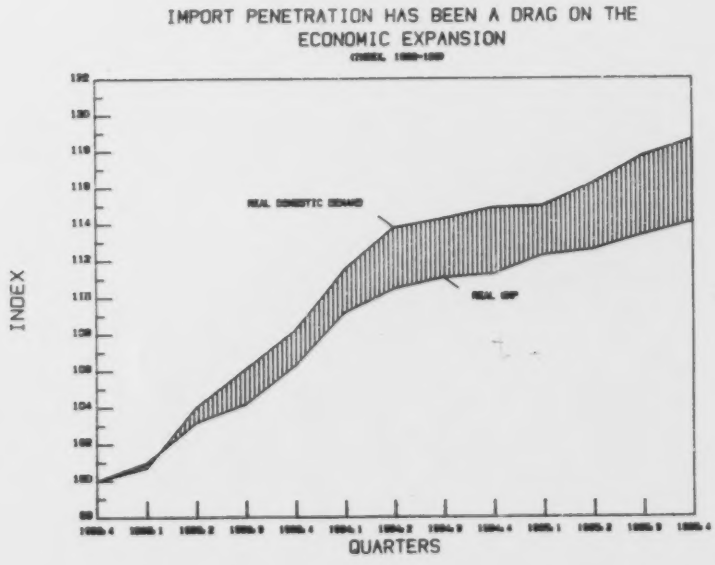
Other factors also played a role in enlarging the trade deficit. The U.S. recovery from the global recession of 1981-1982 came earlier and was much stronger than those of our trading partners; higher demand for goods in this country raised imports while sluggish growth abroad generated weaker growth for our exports. Political uncertainties, weak activity overseas, and pro-investment tax changes here enhanced the attractiveness of the U.S. for investors, putting further upward pressure on the dollar. In addition, the debt crisis experienced by many of our trading partners in Latin America severely constrained their ability to buy U.S. exports.

Nevertheless, most analysts agree that the sharp appreciation of the dollar has been the major factor affecting the trade balance, accounting for more than half the increase in the trade deficit during the 1981-1985 period, according to estimates by the Council of Economic Advisers.

Effects of the Trade Deficit

Virtually all goods-producing industries have been adversely affected by our growing trade imbalance, producing striking disparities between the relatively healthy service sector and the faltering export and import-competing industries. As the trade deficit grew to substantial proportions, reaching 1½ percent of GNP in 1984, it began to exert a noticeable drag on economic growth as domestic demand, which remained relatively strong, was drained abroad.

Chart 5: Domestic Demand and Real GNP



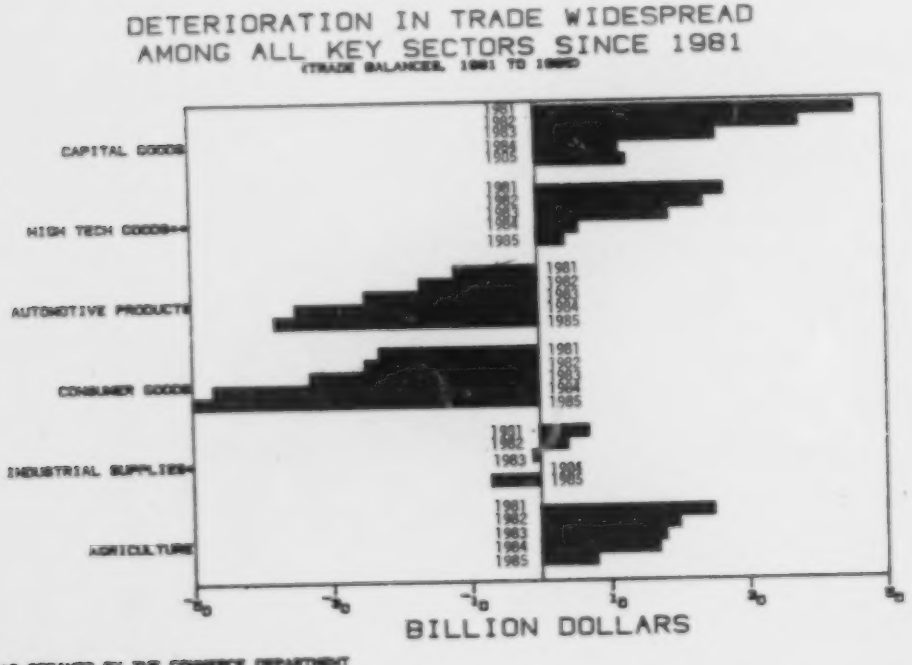
Increasing imports of manufactured goods such as autos, textiles, other consumer goods and metals have been the principle elements in the worsening

trade deficit since 1981. Trade in these goods has been in deficit for some years, reflecting the cost advantages of overseas producers and, in some cases, the failure of U.S. concerns to modernize their production facilities and processes as rapidly as their foreign competitors. However, trade balances in these goods have deteriorated rapidly since 1981, reflecting in large part the price differences between domestic products and imports brought about by rising value of the dollar.

The deteriorating trade situation has produced additional casualties. The highly productive agricultural sector has been particularly hard-hit by the dollar's appreciation. Exports of farm products have dropped by two-thirds since 1981 and, with imports growing more rapidly, the agricultural trade surplus has declined sharply. Along with high interest rates and declining land values, the loss of export markets has had a devastating impact on farming communities across the U.S. Bankruptcies have soared, putting financial pressures on credit institutions that hold farm debt.

Even the traditionally strong high technology and capital goods industries were vulnerable to increasing competition as export growth was sluggish and import penetration increased dramatically.

Chart 6: Trade Balances in Key Sectors



⇔ AS DEFINED BY THE COMMERCE DEPARTMENT
* EXCEPT OIL

The trade deficit has caused a substantial loss of jobs and incomes in those sectors exposed to international competition. Analysts at the Commerce Department have estimated that in 1984 alone the economy lost a net 1.1 million jobs or about 1.3 percent of total employment due to international competition at home and abroad. Reflecting the structural imbalances in the economy, the manufacturing sector lost about 2.3 million jobs while wholesale and retail trade added over 850,000 jobs.

Workers in textiles, primary and fabricated metals, leather and apparel, and motor vehicles were particulary hard hit. Correspondingly, the industrial regions of the Middle Atlantic and North Central States and farming communities across the Midwest and Western States have been the most severely affected.

The U.S. Becomes a Debtor Nation

By living beyond our means we have rapidly amassed a foreign debt that will entail costs in future years. The rapid increase in the trade deficit in the last four years has been financed by large inflows of international capital to supplement domestic savings available to public and private borrowers. This has kept interest rates lower than they otherwise would have been, and has allowed more consumption and investment than could have been satisfied from U.S. production.

The turnabout in our external financial position has been rapid. As recently as 1982 the U.S. was the world's largest creditor, exporting capital to the rest of the world and enjoying the the interest and dividends from that capital. By the end of 1985 that position was reversed: the U.S. was among the world's largest net debtor nations.

Chart 7: The U.S. as a Debtor Nation

There are two serious consequences arising from our net debtor position:

- the increasing debt-servicing burden will require a transfer of real income from the U.S. to foreigners, implying lower living standards in the future

- our continued dependence on capital inflows involves serious financial uncertainties and risks.

Large inflows of capital will continue to be necessary in the immediate future even if our merchandise trade deficit declines because:

- improvements in our goods balance can only occur gradually and with a substantial lag, in response to decline in the dollar's value

- our once substantial surplus in services trade has vanished as a result of the decline in net investment income -- the inevitable consequence of greater foreign ownership of U.S. assets than U.S. holdings of foreign assets.

Consequently, to finance deficits in both goods and services trade, foreign claims will continue to grow, and an increasing share of the national income will be siphoned off to pay interest and dividends abroad as this debt servicing burden grows. In this sense, the trade deficit is feeding on itself in the same way as the domestic budget deficit has been rising by the increasing interest costs of servicing the federal debt.

However, it is by no means clear that international investors will wish to continue to extend large amounts of credit to the U.S. The current large inflows mean that investors are accumulating dollar holdings much more rapidly than other foreign assets; at some point perceptions of relative investment returns and risks will change. This could cause the dollar to fall very sharply and poses a significant risk to the economy because there is no assurance that the depreciation could be managed gradually without sharp increases in inflation, monetary restraint, and interest rates which could precipitate a recession.

International Repercussions

The U.S. budget deficit, combined with anti-inflationary monetary policy, has had reprecussions beyond our borders. The high interest rates and the resulting rise in the dollar's value that this policy mix has produced adversely affected LDC debtor nations. About three quarters of the loans to major debtors are pegged to the U.S. prime rate and its continued high level has added substantially to debt servicing burdens. Moreover, because much of the LDC debt is dollar-denominated, LDCs have been struggling to meet payments on their debts in ever more expensive dollars. These debt problems have created instabilities in world financial markets, particuarly in the U.S., where banks have substantial loans outstanding to Latin American debtors.

The U.S. policy mix also affects economic developments among our major industrialized trading partners. Seeking to curtail the inflationary effects of the decline in their currencies' value against the dollar, they have kept interest rates higher than they otherwise would have. Because governments

were also determined to reduce their budget deficits, there has been little domestically-based stimulus for growth; indeed, a substantial amount of the growth that has occurred has resulted from the export sector. This has led to trade tensions with the U.S.

The recognition of the growing problem of trade imbalances, currency misalignments, the on-going debt problems of many developing countries, and the associated financial instabilities was the key reason for the September 1985 agreement of G-5 finance officials (the U.S., Japan, Germany, France, and the U.K.) to bring about an orderly decline in the value of the dollar.

Since that meeting, the dollar has declined by about 10 percent, which could eventually reduce the trade deficit by some $30 billion, assuming the competitive gains of a weaker dollar are not eroded by higher inflation. However, that would still leave the trade deficit well above $100 billion. Clearly, to have more satisfactory trade performance and remedy global imbalances there must be a fundamental shift in the mix of economic policies. At home, reductions in the budget deficit will need to be accompanied by less stringent monetary policy, which would lessen pressures on domestic interest rates. Abroad, more stimulative fiscal and monetary policies are necessary to offset the contractionary impact of reducing the U.S. budget deficit and maintain world economic growth.

F. Projected Deficits and the Economy

While the "crowding out" effects to be expected from large Federal deficits have so far been noticeable mainly in industries affected by foreign trade, as explained in the previous section, serious pressures would fall on housing and business investment as well if the foreign capital inflow slowed for any reason. If the declining "baseline" budget deficits materialize, these pressures begin to diminish after 1986; they would diminish faster under budgets that reach the Gramm-Rudman deficit targets. Similarly, such deficits would begin to reverse the rising trends in Federal debt and interest that have prevailed since 1980. But, as emphasized above in Section C, there are many potential obstacles to the achievement of baseline or lower deficits and therefore to the realization of these improvements.

Capital Formation

Table 5 shows that the deficits of the 1980s claimed 60 percent of saving by U.S. households, business, and state and local governments. This percentage more than doubled from 27 percent in the preceding decade and 10 percent or less before then. As a result, national saving -- the U.S.-generated saving available to finance new investment in housing, plant, and equipment -- dropped from 6-7 percent of GNP to 3 percent.

Table 5

Federal Deficits and National Saving
(Annual averages, $ billions)

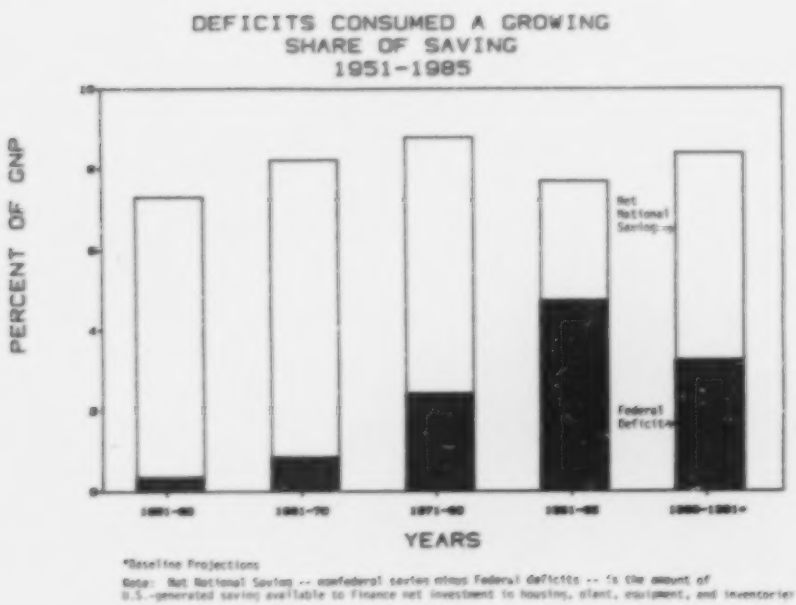
	1951-60	1961-70	1971-80	1981-85	1986-91 Baseline
Nonfederal Saving (saving by U.S. households, business, and state and local governments)	30	62	157	268	427
Federal Budget Deficits	1	6	42	162	155
Net National Saving	29	56	115	106	272
Deficits as Percent of Nonfederal Saving	3	10	27	60	36
Net National Saving as Percent of GNP	7	7	6	3	5

Note: Saving is measured net of allowances for the depreciation of the capital stock -- the actual economic depreciation, not tax law depreciation. The reason for focusing on net rather than gross saving is that it is net additions to the capital stock which raise productivity and living standards. Depreciation allowances are not part of the saving pool available to finance Federal deficits and new investment, since they must be used for investment which just keeps the current capital stock intact.

Under the baseline projection, average deficits would be about the same as in the first half of the 1980s while saving grows with the economy. Deficits would consume a smaller but still-high share of saving -- still 22 percent even in 1991. National saving would rise to 5 percent of GNP for the six years as a whole and 6 percent by the end of the period, equaling the decade of the 1970s but still falling short of the 1951-70 average. Under administration proposed budget policies, or other policies which achieved similar deficits, the improvement would be more pronounced.

Figure 8 illustrates the rise in deficits and resulting erosion in net national saving in the 1980s and the partial recovery that is possible if baseline deficits can be achieved.

Figure 8



*Baseline Projections

Note: Net National Saving -- combined saving minus Federal deficits -- is the amount of U.S.-generated saving available to finance net investment in housing, plant, equipment, and inventories

Historical data on debt and capital stock confirm that there has been an inverse relation between growth in the Federal debt and growth in the capital stock.

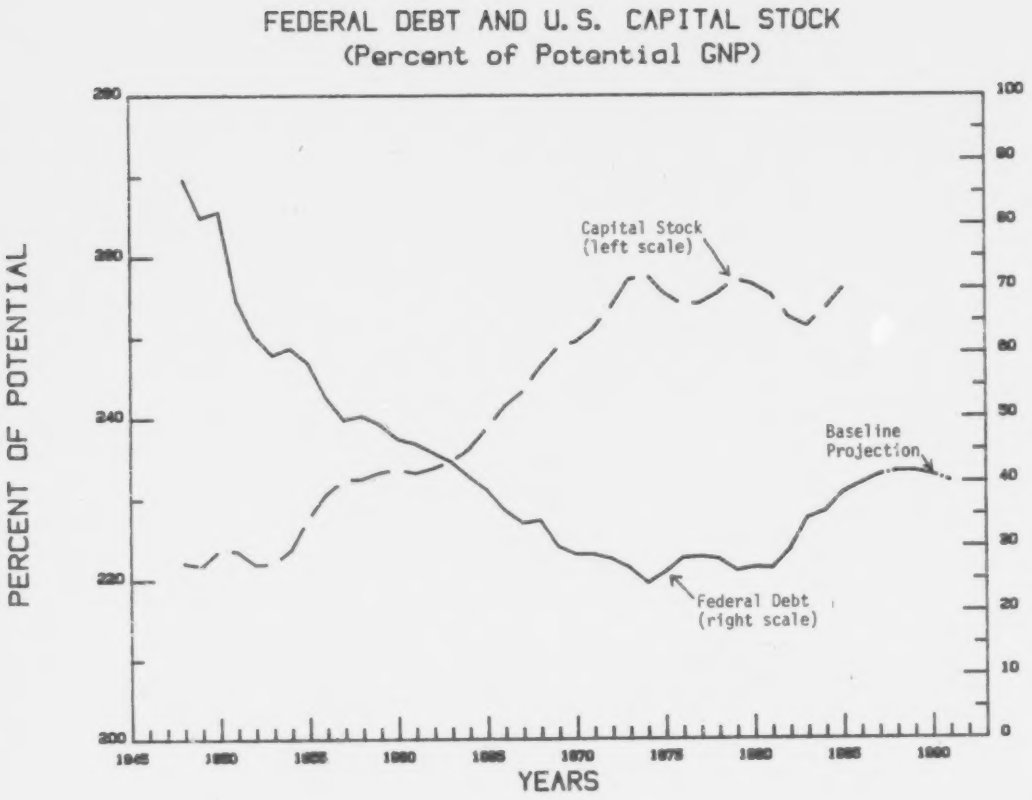
- During World War II, the last period of sustained Federal debt growth, the capital stock actually was allowed to run down. Because of wartime controls, the "crowding out" took place through direct control of production instead of through high interest rates.

- After the war, a long period of decline in the debt/GNP ratio coincided with a long and productive buildup in the capital stock, as shown in Figure 9. (The capital stock includes business capital, residential housing, investments by state and local governments, and consumer durable goods, all of which rely on debt finance and therefore compete with Federal government securities in capital markets.)

- About 1974, the debt/GNP ratio leveled off, and after 1981 it began to rise sharply. This last decade has also seen a marked change in the trend of the ratio of the capital stock to GNP, from a pronounced uptrend to a slight downward tilt, and a slowdown in the growth of productivity and living standards. The investment incentives and foreign capital inflows of the 1980s do not appear to have reversed the downtrend: there has been some recovery in net investment from its 1983 recession low, but the 1985 capital stock ratio remains below its previous cyclical high in 1979. Productivity and living standards similarly are growing more slowly than before 1980.

The debt/GNP ratio begins to decline in 1989 under baseline deficits. With the size of deficits that would be achieved with administration policies, the debt ratio would begin to decline sooner and fall more rapidly. Under such budgets, if economic growth also can be maintained, more rapid improvements in capital stock, productivity, and living standards can be expected.

Figure 9



Notes:

Potential GNP: the constant-dollar GNP that would be associated with an unemployment rate representing an unchanging amount of labor market slack. Currently, an unemployment rate of 6 percent is used in these calculations.

Federal debt: Federal debt held by the public as a percent of the current-dollar value of potential GNP.

Capital stock: Total net, 1982-dollar capital stock for the following four categories: private fixed nonresidential, residential, fixed state and local, and consumer durables, as a percent of potential GNP.

Projections of Debt and Interest and Implications for the Future

As recently as last year, current policy five-year projections by the Congressional Budget Office showed debt and interest continuing to rise as a percent of GNP. This made budget projections increasingly sensitive to interest rates and suggested the possibility of pressure on the Federal Reserve to hold down interest rates by "monetizing" the debt. Excessive monetary ease could lead to overstimulation of the economy and a reacceleration of inflation.

The latest baseline, in contrast, shows a leveling off and then decline in debt and interest relative to GNP, as can be seen in Table 6. Under administration policies, these ratios would show earlier and steeper declines.

Table 6

Debt and Interest Burdens
(Fiscal years)

	Actual		Projected					
	1980	1985	1986	1987	1988	1989	1990	1991
				Baseline				
Debt Held by the Public (end of year, $ billions)	715	1510	1721	1898	2061	2206	2328	2434
per person (dollars)	3149	6335	7155	7820	8417	8932	9349	9698
Percent of GNP	26.8	38.4	41.0	42.1	42.6	42.3	41.4	40.2
Net Interest Payments, $ billions	52.5	129.1	137.7	144.1	154.3	157.7	159.4	159.5
per person (dollars)	231	542	573	594	630	639	640	635
Percent of GNP	2.0	3.3	3.3	3.2	3.2	3.0	2.8	2.6
Percent of Budget	8.9	13.8	14.0	14.1	14.2	13.8	13.4	12.7

Under the baseline projection, the risks of exploding interest costs and pressures to monetize the debt appear diminished. However, this does not necessarily indicate that further deficit reductions such as those required by Gramm-Rudman are superfluous. The baseline assumes policies that may not eventuate and is based on fairly optimistic economic assumptions. Baseline assumptions were discussed earlier in this chapter.

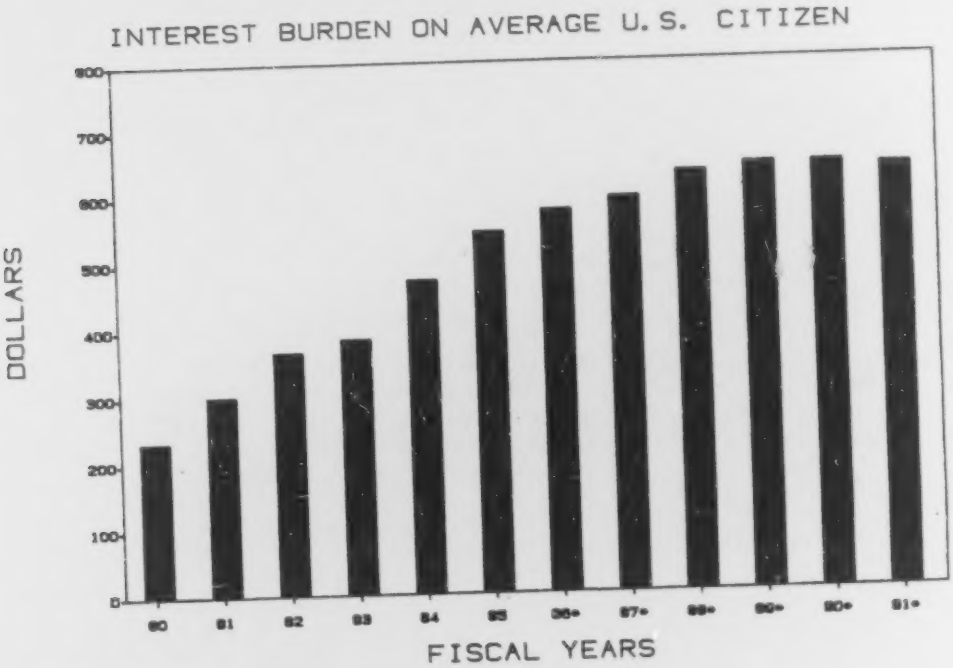
In particular, the baseline assumes low inflation and consequent low interest rates as well as no unusual requirements for spending consequent on financial instability, e.g. payouts of Federal deposit insurance. In fact, the low oil and farm prices that contribute to low inflation can also lead to higher farm program payments and more financial failures.

Since the Federal Reserve allowed rises in the narrowly defined money supply during 1985 that were far above its targets, some have questioned whether there has already been a dangerous degree of debt monetization. This seems unlikely. Much of the money supply rise appears to have been required to satisfy a desired increase in cash holdings. The economy does not display the signs of a money-fueled inflationary boom that would be an initial symptom of debt monetization. But it is highly uncertain how much continued money growth will be required to keep interest rates low in the presence of continued deficits or how inflationary that money growth would be. Hence, prudence against a resurgence of inflation still suggests an eventual return to budget balance at high levels of economic activity.

Interest Burdens: The Legacy of the Recent Increase in Debt

As the Federal debt burden has risen, so has the share of the budget and of GNP that must be devoted to interest payments: from 2.0 to 3.3 percent of GNP, and from 8.9 to 13.8 percent of the budget, over the five years 1980-1985. As shown in Figure 10, the Federal interest burden on each man, woman, and child in the U.S. more than doubled between 1980 and 1985. Under the baseline projections the rise in the interest burden would be substantially slowed, but the legacy of the early 1980s would remain.

Figure 10



• BASELINE ESTIMATES

This growing interest burden has contributed to the growing inequality in the distribution of income. Some interest paid to the holders of the Federal debt returns to the Treasury as personal taxes and as Federal Reserve earnings. Some is held by insurance companies and private, state, and local pension funds. Interest paid to such holders, as well as that paid out on savings bonds, benefits middle-class workers and savers. But inevitably the prime beneficiaries of large interest payments at high real interest rates are the wealthy. Financial wealth -- that is, holdings of financial assets net of debt owed -- is highly concentrated. According to the 1983 Survey of Consumer Finances, the wealthiest 2 percent of families hold 54 percent of total net financial assets. Hence, a substantial portion of government interest payments benefits these wealthy families. In addition, 14 percent of the debt held by the public is held by foreigners.

G. The Economics of "Privatization" and Asset Sales

The administration has advocated the sale of government assets to the private sector in order to get the government out of activities that it believes the private sector could perform more efficiently, a "privatization" of government activities. In addition, the administration has argued that the sale of public assets will reduce the budget deficit and contribute to fiscal restraint. Careful analysis, however, indicates that privatization cannot be justified on the basis of budgetary or fiscal policy effects, because these are minimal. The real issue raised by privatization is the role of government and whether the Federal government or the private sector should provide certain services to citizens. A detailed description of the administration's proposals appears in Section V.

The Role of Government

The Federal government provides its citizens with some services on more favorable terms than could be provided by the private sector. For example, the government's direct loan and loan guarantee programs are designed to redirect economic resources to particular uses such as education or small business formation, or particular recipients such as low or moderate income families. It often does this by providing credit which would otherwise be unavailable or available only at higher cost from private sources. Similarly, in some areas the Federal government provides electric power to users below prevailing market rates. The issue raised by privatization is whether the public at large should continue to support certain activities of this type or whether society would benefit if these services were provided at market rates by the private sector. Such judgments depend on a case-by-case assessment. Public policy decisions on asset sales should be made on these grounds and not on largely irrelevant budget and fiscal policy considerations.

Impact on the Budget

Receipts from the sale of income-producing assets would reduce the budget deficit as currently measured in the year such receipts were collected. However, such sales would not permanently reduce the deficit because the future savings in interest costs resulting from the reduction in Treasury debt would tend to be offset by the loss of future income on assets that were sold. Absent further asset sales in the following year, the deficit would rise towards its former level. Depending on the price at which the assets could be sold, future deficits could be larger than they would have been without the asset sales. Consequently, asset sales generally provide only a temporary reduction in the budget deficit.

Impact on Fiscal Policy

The sale of assets would have very little impact on fiscal policy. These assets would merely replace Treasury securities in the portfolios of private investors, absorbing private saving just as Treasury borrowing does. There would be no significant change in national saving. Because asset sales would not reduce the government's demand on credit markets, they would not relieve the burden of the deficit: the upward pressure on interest rates that crowds out private investment or increases the trade deficit and crowds out exports and domestic manufacturing.

H. Economic Implications of Fiscal Policy under Gramm-Rudman

Fiscal policy has recently been very stimulative; the structural deficit has increased from 1.1 percent of GNP in 1982 to 3.9 percent in 1985. Under the administration's proposal which meets the deficit targets in Gramm-Rudman, fiscal policy would be put on an increasingly restrictive path during the next five years, a radical reversal of the fiscal policy put in place in 1981.

The fiscal year 1986 budget resolution adopted spending and revenue targets which would have put the deficit on a gradually declining path, in spite of a higher than projected, but temporary, increase in the 1986 deficit from lower revenues and higher agriculture and defense spending. However, the fiscal year 1987 deficit target of $144 billion requires a large increase in fiscal restraint by 1.5 percent of GNP in 1987, from a structural deficit of 3.8 percent of GNP in 1986 to 2.4 percent in 1987. In fiscal year 1988 the structural deficit would decline by another 1.0 percent of GNP, so that the cumulative restraint over two years would be 2.5 percent of GNP. Meeting the deficit targets in subsequent years implies additional fiscal contraction, although more time would be available for adjustment.

In the past, fiscal changes of comparable magnitude have been followed by significant weakness in the economy. For example, in reaction to excessive fiscal stimulus and inflation during the Vietnam escalation in 1965-68, there was a fiscal policy shift of 3.4 percent of GNP towards restraint in 1969 and 1970, followed by a recession in 1970. Earlier, in 1960 and 1961 there was fiscal restraint totaling 2.6 percent of GNP, which was also followed by a recession. However, in both these instances, monetary policy was deliberately tightened concurrently with fiscal policy to slow the economy and prevent a rise in inflation. The current situation is different but still poses problems of policy coordination.

The principal objective over the next several years is to shift the policy mix by reducing fiscal stimulus gradually while easing monetary policy sufficiently to ensure continued economic expansion. This presents questions of both the timing and magnitude of the prospective policy changes. Changes in monetary policy are generally thought to take from six to nine months to affect economic activity; the Federal Reserve will have to act during early 1986 to mitigate the restrictive impact of the large shift in fiscal policy contemplated under Gramm-Rudman which is to take effect in late 1986 and early 1987. Even if monetary actions are taken early, there is the additional question of whether they will be large enough to offset the large fiscal contraction.

There are major uncertainties about the size of these "trade-offs" between monetary and fiscal policy, especially when the changes are as large as required by Gramm-Rudman. As a result, policy changes designed to reach long-term fiscal goals rapidly carry a substantial risk of slower growth or recession in the short term. This suggests that the administration's assumption of 4 percent real growth in 1986 and 1987 may turn out to be inconsistent with the fiscal policy in the President's budget.

III. THE ECONOMY: REVIEW AND OUTLOOK

A. Summary

- After a deep recession, the economy recovered rapidly until mid-1984. However, the recovery then slowed sharply in late 1984 and 1985, with little further reduction in unemployment. Over three years, economic recovery has been no stronger than the postwar average, and the economy remains below its production potential and the operating rates during the previous recoveries.

- Budget deficits have temporarily stimulated, but also distorted, economic growth. Deficits have caused a very high value of the dollar and record trade deficits, leading to job and income losses in exporting and import-competing industries.

- Over the full five years 1981-85, inflation has been reduced dramatically, but growth and net investment have been below the average of earlier periods and unemployment and real interest rates far above average. Growth and job creation have fallen far short of the administration's projections made in 1981.

- The administration is forecasting somewhat stronger economic growth than the typical private-sector forecast, along with much lower interest rates after 1987. These optimistic forecasts lead to more optimistic deficit projections, especially in later years.

- The principal risk to the optimistic forecast is that instability in the flow of foreign capital will lead to a clash between private and Federal credit demands leading to higher real interest rates and lower investment. In addition, demographic and productivity trends in the late 1980's may not be as favorable as assumed by the administration. However, a sustained drop in oil prices could substantially mitigate these problems and sustain stronger growth.

B. Economic Performance, 1981-1985

During 1981-82 the U.S. economy underwent a severe recession as a result of a tight money policy intended to reduce inflation. Recovery from this recession began in the winter of 1982-83, propelled by a marked easing of monetary policy and the strong fiscal stimulus put in place by the administration. At first, recovery was extremely rapid, as can be seen on Figure 1. However, economic growth slowed abruptly after early 1984. Since then there has been little further improvement in the unemployment rate and no further improvement in the broader measure of economic achievement -- real GNP relative to potential -- that is shown in Figure 1. Real GNP relative to potential is lower than at the comparable point in previous cycles, and unemployment is higher.

This slowdown is not for lack of stimulus from the budget. The structural deficit has increased each fiscal year since 1982 in absolute terms and relative to GNP. However, much of this fiscal stimulus has leaked overseas in the form of the record trade deficits discussed in the previous chapter. At the same time, interest rates have been declining in response to both Federal Reserve easing and the massive net inflow of capital which has mitigated the upward pressure of the deficits on interest rates.

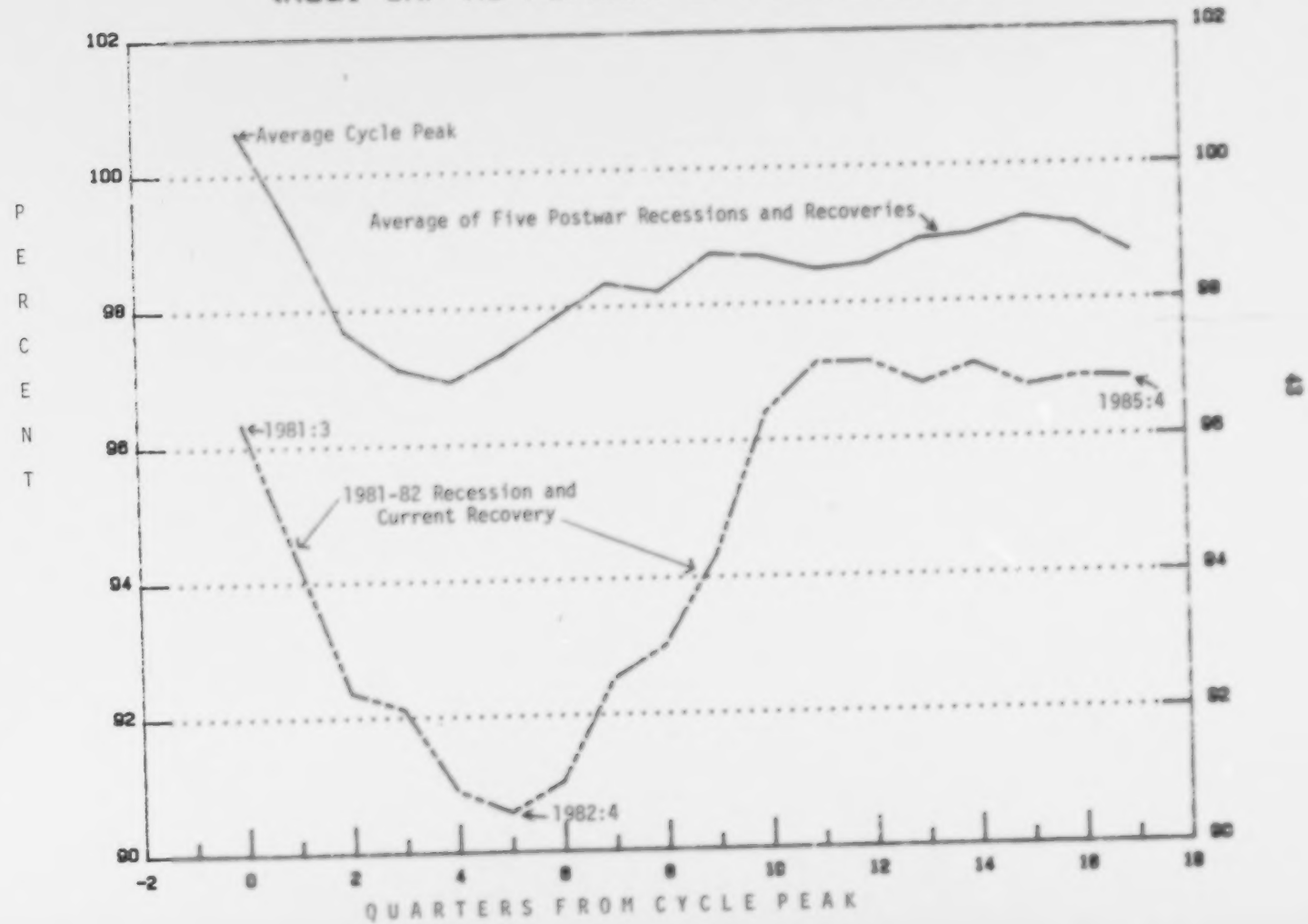
Economic performance during the 1981-85 period has been quite mixed, and perhaps disappointing, relative to average postwar experience and especially to the administration's own projections in 1981. Table 1 compares 1981-85 with earlier postwar periods; in Table 2, key economic indicators for 1981 through 1985 (with a forecast of 1986) are compared with the projections made by the administration in March 1981.

The major economic achievement of the last four years was the sharp reduction in inflation, which exceeded even the administration's own projections. This was primarily the result of the Federal Reserve's relentless monetary restraint throughout 1981 until mid-1982, which was supported, sometimes sporadically, by the administration. The administration's fiscal policy can be credited indirectly with some of the reduction in inflation, however, in that the surge of low-priced imports resulting from large budget deficits and the overvalued dollar has kept inflation low in the short term, an effect which will be reversed as the dollar falls.

In most other respects the last four years have been disappointing compared with either previous postwar experience or the administration's own projections. Economic growth has been lower, and unemployment higher. Interest rates, nominal and real, have been higher. Instead of the projected near-balance, the budget deficit was $212 billion in 1985.

Gross investment in plant and equipment has accounted for an unusually large share of GNP in the 1980s, in spite of the recession, possibly because of the large investment incentives in the 1981 tax bill. To the extent that it has been caused by tax incentives, the effect is likely to be transitory. Furthermore, because much of the investment has been in short-lived, fast-depreciating capital goods, net additions to the business capital stock during 1981-85 were at the lowest rate in the postwar period. It is net investment -- gross investment minus the investment required to replace depreciating capital -- that is important for growth in business productivity.

RECESSION AND RECOVERY:
CURRENT AND HISTORICAL AVERAGE
(Real GNP As Percent of Potential GNP)



Even this disappointing performance in business investment was achieved partly at the expense of housing. Gross fixed investment including housing was no larger as a share of GNP than it had been in the 1970s, and net investment including housing dropped more sharply than net business investment.

Table 1

Selected Aggregate Measures of Economic Performance

	1951-60	1961-70	1971-80	1981-85
Real GNP Growth (average annual rate, calendar years, percent)	3.3	3.8	2.8	2.3
Unemployment Rate (civilian, percent)	4.5	4.7	6.4	8.3
Inflation - GNP Deflator (average annual rate of increase during period, percent)	2.6	3.1	7.4	5.4
Interest Rates (three month Treasury bills, percent)	2.2	4.3	6.8	10.1
Real Interest Rate (nominal interest rate minus inflation rate)	-0.4	1.2	-0.6	4.7
Gross Business Fixed Investment (percent of GNP, annual average)	9.6	9.9	10.8	11.5
Net Business Fixed Investment (percent of net national product, annual average)	3.3	3.8	3.6	2.8
Gross Fixed Investment, including housing (percent of GNP, annual average)	15.0	14.5	15.8	15.7
Net Fixed Investment, including housing (percent of net national product, annual average)	6.9	6.6	6.7	4.8

Table 2

Economic Performance, 1981-86: 1981 Projections [1/] and Actual Outcomes

	1981 Projections [1/]						Actual					Preliminary Forecast
	1981	1982	1983	1984	1985	1986	1981	1982	1983	1984	1985	1986
Total Budget Surplus (+) or Deficit (-) (Fiscal year, $ billions)*	-78.5	-61.7	-33.5	-9.0	-1.6	+21.7	-78.9	-127.9	-207.8	-185.3	-211.9	-208.9
Economic Growth (percent increase in real GNP from 1980)	1.1	5.3	10.6	15.6	20.4	25.5	1.9	-0.7	2.8	9.6	12.1	15.9
Unemployment Rate, civilian (percent)	7.9	7.3	6.7	6.5	6.1	5.7	7.6	9.7	9.6	7.5	7.2	6.9
New Jobs (millions created since 1980)	2.0	4.0	6.0	8.0	10.5	13.0	1.1	0.2	1.5	5.7	7.9	9.9
Inflation Rate (percent change in GNP deflator year-over-year)	9.9	8.3	7.0	6.0	5.4	4.9	9.6	6.5	3.8	4.1	3.3	3.6
Interest Rates (three-month treasury bills, percent)	11.1	8.9	7.8	7.0	6.0	5.6	14.0	10.7	8.6	9.6	7.5	6.8

* The fiscal year 1982 budget projected that the unified budget deficit, as then defined, would reach balance in fiscal year 1984.

1/ Source: Executive Office of the President/Office of Management and Budget, Fiscal Year 1982 Budget Revisions, March 1981.

C. The Administration's Economic Forecast, 1986-1987

General Character of the Forecast

The administration has altered its economic forecast only slightly from that presented with the budget submission last February and the Mid-session review in August. Real economic growth rises from the sluggish 2.5 percent rate of 1985 and remains relatively rapid through 1991. Inflation stays near recent levels through 1987 before beginning a rapid decline through 1991. Interest rates are forecast to be at or above current levels in 1986, and are projected to decline faster than the inflation rate in 1987-1989. The major economic assumptions in the administration's budget are shown in Table 3.

Real GNP is forecast to increase by 4.0 percent in both 1986 and 1987; this is the same rate which the administration has been projecting for these years since January 1983. The civilian unemployment rate (excluding military personnel) is forecast to average 6.8 percent in 1986 and 6.6 percent in 1987.

The administration inflation forecast, completed before the recent sharp fall in spot oil prices, shows the CPI rising by 3.7 percent in 1986 and 4.1 percent in 1987. Although this is lower than the forecasts of inflation made last year, it is a moderate increase from the 3.3 percent rate during 1985.

Interest rates on three month Treasury bills are expected to average 7.3 percent in 1986 and 6.5 percent in 1987. This interest rate has been about 7.0 percent during January, 1986.

Comparison with Other Economic Forecasts

Table 4 presents a comparison of the administration's short-term forecast with the consensus of two groups of private analysts: the Blue Chip Economic Indicators panel of fifty forecasters, and the average of three major commercial econometric model services.

The administration forecast is similar in many respects to the private analysts' outlook for the next two years. The major difference is that the administration's 4 percent real GNP increase appears rather optimistic; the other economists expect moderate growth of 3 percent or lower in both years. Reflecting this weaker growth and lower oil prices, the private forecasters look for lower interest rates and slightly lower inflation in 1986. The administration forecasts an increase in current dollar GNP of 8 percent or more in both years, while the others look for an increase of 6-7 percent in 1986 and about 6½-7½ percent in 1987.

In 1985 the economy performed far below the expectations of most analysts, and even further below the administration forecast. The major reasons behind this were the greater drag on output exerted by the deterioration of the foreign trade deficit and the cautious inventory positions taken by nonfarm businesses. While it is unlikely that the economy in 1986 will be as sluggish as it was in 1985, until the oil price break in mid-January the major risks were preponderantly on the down side. However, if oil prices remain near $20 per barrel rather than at the $24-$25 previously forecast, growth would be stronger and could approach 4 percent during 1986.

The beneficial effects of lower oil prices derive directly from the consequent lower inflation: the purchasing power of consumers and businesses would increase, the Federal Reserve could lower interest rates, and both consumption and investment would rise. In addition, the trade balance would improve due to the lower bill for imported oil and the higher growth rates expected in a number of our export markets. The stronger economy and improved trade situation would reduce the potential for a sharp and disruptive fall in the exchange rate.

There are, however, several domestic and international problems associated with a fall in oil prices to below $20 per barrel. First, the oil and other energy producing areas of the country would be adversely affected, losing income and employment. This would increase the exposure to losses of financial institutions with significant loans to energy producers. Serious problems would also be caused for countries such as Mexico, Nigeria and Indonesia which depend on revenues from oil exports to finance economic development and service past debt, since they would face a sharp contraction in income.

Two major favorable factors which will affect the economy in 1986 have roots in developments during 1985:

- The trade balance should begin to improve due to the 10 percent decline in the exchange rate during 1985, most of which occurred in the second half. The growth of imports should slow and exports should increase during the first half of the year.

- The decline in interest rates in the the second half of 1985 should have a stimulative effect on housing and some business investment. A further easing of interest rates due to lower inflation, more expansive monetary policy, or favorable market response to the prospect of lower Federal deficits would also improve performance in interest-sensitive sectors later in the year.

Factors which many analysts expected would depress growth early in 1986 are still present, although their effects may be outweighed by lower oil prices. These include:

- A high consumer debt burden and low personal saving rate, which may slow the growth of consumption early in the year. For most of the second half of 1985 personal consumption increased faster than disposable income; in the past, this has usually preceded a slowdown. There are a number of reasons to believe that the expansion of personal debt in 1985 was less burdensome than during comparable periods in the past, but consumer spending will not lead the economy in 1986 as it did in 1985.

- Business investment spending is expected to weaken, according to surveys taken in late 1985, reflecting relatively low capacity utilization and saturation of office and industrial building markets in many areas. Uncertainty associated with tax reform proposals concerning investment incentives may have the effect of moving some investment forward into 1986, and investment in 1987 would be

adversely affected. Investment in 1986 may be lower if businesses postpone marginal projects until final legislation is passed.

- The final major risk is also associated with policy uncertainty. Most analysts believe that if the Gramm-Rudman deficit targets for 1987 and subsequent years are to be achieved, monetary policy must be eased enough in advance that the effects of lower interest rates can spread through the economy. If the deficit is sharply reduced without a timely easing of monetary policy, growth in late 1986 and early 1987 would be slower and the risk of recession would increase.

Table 3

Major Economic Assumptions in the
Administration's Fiscal Year 1987 Budget
(percent change)

	Actual	Calendar Years					
		Forecast		Projections			
	1985	1986	1987	1988	1989	1990	1991
Fourth Quarter to Fourth Quarter							
Gross National Product:							
Current dollars	5.8	8.0	8.3	7.7	7.0	6.2	5.6
Constant (1982) dollars	2.5	4.0	4.0	4.0	3.7	3.6	3.5
GNP deflator	3.2	3.8	4.1	3.6	3.2	2.5	2.0
Consumer Price Index-W	3.3	3.7	4.1	3.5	3.2	2.5	2.0
Unemployment rate (percent, fourth quarter)*	7.0	6.8	6.6	6.3	6.1	5.8	5.6
Annual Averages							
Gross National Product:							
Current dollars:							
Level ($ billion)	3992	4274	4629	4995	5359	5709	6036
Percent change	5.8	7.0	8.3	7.9	7.3	6.5	5.7
Constant (1982) dollars	2.3	3.4	4.0	4.0	3.9	3.6	3.5
GNP deflator	3.3	3.5	4.2	3.7	3.3	2.8	2.1
Consumer Price Index-W	3.5	3.5	4.1	3.7	3.3	2.8	2.1
Unemployment rate (percent)*	7.2	6.8	6.6	6.4	6.2	5.9	5.7
3-month Treasury bill rate (percent)	7.5	7.3	6.5	5.6	4.8	4.3	4.0

* Percent of civilian labor force.

Table 4

Comparison of Administration Economic Forecast
With Private Forecasts For 1986-1987
(percent change)

		1986			1987		
Fourth Quarter to Fourth Quarter	1985 Actual	Admin.	Blue Chip	Commercial Services*	Admin.	Blue Chip	Commercial Services*
Gross national product: Current dollars	5.8	8.0	7.0	6.3	8.3	7.4	6.6
Constant (1982) dollars	2.5	4.0	3.1	3.0	4.0	2.8	3.1
GNP deflator	3.2	3.8	3.8	3.2	4.1	4.5	3.4
CPI-W	3.3	3.7	3.8	3.2	4.1	4.6	3.6
Unemployment rate (%)**	7.0	6.8	6.9	6.8	6.6	6.8	6.6
Annual Averages							
Gross national product: Current dollars	5.8	7.0	6.6	5.9	8.3	7.4	6.6
Constant (1982) dollars	2.3	3.4	3.0	2.6	4.0	2.9	3.1
GNP deflator	3.3	3.5	3.5	3.2	4.2	4.3	3.4
CPI-W	3.5	3.5	3.6	3.2	4.1	4.3	3.6
Unemployment rate (%)**	7.2	6.8	7.0	6.9	6.6	6.9	6.7
3-month Treasury bill rate (percent)	7.5	7.3	7.1	6.7	6.5	7.4	6.9

*Average of Data Resources, Chase Econometrics and Wharton EFA, Inc. forecasts of late January 1986.

**Percent of civilian labor force.

D. The Administration's Long-Term Economic Projections, 1988-1991

The long-term economic projections are very similar to those which the administration has used in the past. Real GNP grows steadily, averaging 4 percent from 1986 to 1988, with a gradual decline to 3.5 percent in 1991. The inflation rate declines from around 4 percent in 1987 to only 2 percent in 1991. Nominal and inflation-adjusted interest rates also fall throughout the projection period, with the three-month Treasury bill rate averaging only 4.0 percent in 1991. The spread between long and short-term interest rates narrows significantly, from 3.1 percentage points in 1985 to only .5 points in 1991. Table 5 presents these projections and compares them with the average of the most recent commercial service projections.

As in the past, the administration is significantly more optimistic about the long run prospects for the economy than are most private economists. Between 1986 and 1991 the administration expects real GNP growth to average 3.8 percent annually while the private forecasts show only 3.0 percent per year. In addition, the private analysts expect inflation to level off rather than decline, and consequently project higher interest rates and a greater spread between short and long-term interest rates. Unemployment is higher in the private forecasts due to the slower real growth, with the civilian rate at 6.3 percent in 1991 in contrast to the administration's projection of only 5.7 percent.

These differences in the economic projections have significant impacts on the budget. If the economy performs closer to the private projections than to those of the administration, deficits for the entire period will be substantially higher. Weaker real growth combined with correspondingly more rapid inflation results in lower revenues due to the indexation of personal taxes. While the higher unemployment and inflation both add to outlays for many entitlement programs under current laws, the most important impact is due to the difference in interest rates. By 1991 the difference in the level of short-term rates alone (not accounting for the wider spread between short and long rates) would add nearly $35 billion to the deficit.

The total impact on the deficit if the economy performs as projected by the services could be as much as $14 billion in fiscal year 1987, $40 billion in fiscal year 1989, and $55 billion in fiscal year 1991. This is by no means a "worst case" possiblility, since it still assumes the longest economic expansion in postwar history, with no recession in the next six years.

Analysis of the Long-Term Outlook

The administration notes that its long-term projections, like most others, are not intended to be precise forecasts of future economic conditions. They are trend projections assumed to be consistent with the administration's economic policies, including the gradual deceleration of the growth of current dollar GNP through monetary restraint. Like other such projections, they tend to be optimistic because they do not incorporate unpredictable shocks and cyclical factors which can affect prices, productivity, and output.

Even disregarding such shocks, these projections are optimistic. Trends in aggregate productivity suggest that nominal GNP growth is unlikely to split as favorably between strong real growth and low inflation as assumed by the administration. For example, rather than returning to the rates achieved in the 1960's, total productivity in the nonfarm business sector grew at only a 1.6 percent annual rate from 1982 through 1985, and did not increase at all during 1985. If productivity does not grow more rapidly for the rest of the decade, achieving the real growth assumed by the administration while holding down inflation seems unlikely.

The adjustment of the foreign trade sector will be a critical factor in the long term outlook. Most long-term projections assume that the United States will continue to run a relatively large trade deficit for the rest of the 1980's, accumulating additional net foreign debt. Even with a declining Federal budget deficit, this continuing capital inflow poses a difficult adjustment problem.

The problem is that monetary policy must walk a very fine line between ease and restraint. Monetary policy designed to rapidly reduce interest rates could cause a sharp fall in the exchange rate with an accompanying sharp decrease in the volume of net capital inflow, raising interest rates and stalling economic growth. On the other hand, fiscal restraint unaccompanied by some monetary ease also could slow growth.

Clearly, there are also favorable contingencies, including a permanently lower level of oil prices which allows more growth and lower inflation. Better coordination of macroeconomic policies among the major industrial nations, suggested in the G-5 meetings since September 1985, would also provide the foundation for more rapid and stable growth. On balance, however, trends in supply factors (particularly slower labor force growth and the recent low rate of net investment) combined with the risks present in the current international economic situation suggest that the administration economic projections for 1988-1991, while not impossible, are exceedingly optimistic.

Table 5

Comparison of Administration and Commercial Forecasting Services Long-Term Economic Projections
(percent change)

	Actual	Calendar Years					
		---Forecast--		----------Projections---------			
	1985	1986	1987	1988	1989	1990	1991
Annual Averages							
Gross National Product							
Current dollars:							
Administration	5.8	7.0	8.3	7.9	7.3	6.5	5.7
Commercial Services*		5.9	6.6	6.7	7.6	7.6	7.4
Constant (1982) dollars							
Administration	2.3	3.4	4.0	4.0	3.9	3.6	3.5
Commercial Services		2.6	3.1	2.8	3.0	3.0	3.0
GNP deflator							
Administration	3.3	3.5	4.2	3.7	3.3	2.8	2.1
Commercial Services		3.2	3.4	3.8	4.5	4.5	4.3
Consumer Price Index							
Administration	3.5	3.5	4.1	3.7	3.3	2.8	2.1
Commercial Services		3.2	3.6	3.8	4.5	4.4	4.2
Unemployment rate (percent)**							
Administration	7.2	6.8	6.6	6.4	6.2	5.9	5.7
Commercial Services		6.9	6.7	6.5	6.4	6.4	6.3
3-month Treasury bill rate (percent)							
Administration	7.5	7.3	6.5	5.6	4.8	4.3	4.0
Commercial Services		6.7	6.9	6.6	7.2	7.0	6.7

*Average of Chase Econometrics, Data Resources, Inc. and Wharton EFA, Inc.

**Percent of civilian labor force.

IV. REVENUES AND TAX POLICY

A. Summary

- Over the next five years, under current law, revenues will rise no more than a few tenths of a percentage point compared to Gross National Product. The administration's deficit reduction plan increases net revenues by less than 1 percent compared to current law (one-tenth percent per year compared to GNP) does not cut social security retirement benefits, and increases defense. As a result, deficit reduction depends heavily on cutting domestic discretionary and some entitlement spending.

- The administration renews its earlier calls for two tax incentives for private education: tax credits for elementary and secondary education costs, and higher education tax-preferred savings accounts. These proposals are put forward notwithstanding the administration's expressions of general support for tax reform that would eliminate tax preferences and lower tax rates. The budget does not include a repeat recommendation for enterprise zone tax incentives; however, the budget document states that "once tax reform has been enacted," enterprize zones will be reproposed.

- The administration more than offsets the revenue loss from these tax write-off proposals by calling for increases in tax enforcement and in a variety of narrow-base or special purpose taxes and fees. Over five years, about half of the revenue increase comes from Internal Revenue Service recommendations. For fiscal year 1987, the administration estimates that its revenue proposals would raise $6.3 billion above a base of $844.1 billion. The largest revenue raisers in 1987 are extension of the current temporary 16 cent cigarette tax, an increase in Federal employee and District of Columbia contributions toward retirement, assignment of unclaimed oil price overcharges to the Federal government, Internal Revenue Service fees, penalties and stepped up collection efforts, and acceleration of state payroll tax deposits. Some of these items were incorporated by Congress in the Conference Report on the Omnibus Reconciliation Act of 1985 (H.R. 3128), which has not been enacted. A number of these items have been proposed before and considered by Congress without legislative results.

- The administration has, outside the budget, proposed sweeping changes in the income tax code in order to lower tax rates generally and lift income tax burdens from the poor. The tax reform proposal includes substantial increases in corporate income taxes, but these increases are used to lower individuals' taxes rather than to reduce the deficit.

  The House has modified the administration tax reform proposal and sent its bill, H.R. 3838, to the Senate where it awaits action. H.R. 3838 would reduce tax rates, lift taxes from the poor, and would be revenue neutral over the five years after enactment. H.R. 3838 uses four tax brackets for individuals, lowering individual tax rates to 15 percent, 25 percent, 35 percent, and 38 percent. The corporate rate is lowered from 46 percent to 36 percent. The personal exemption is increased to $2,000 for non-itemizers, the standard deduction (i.e. zero bracket amount) is increased, and the earned income tax credit made more generous.

These tax cuts are paid for by cutting back on a wide variety of tax write-offs (e.g. deductions, credits, and business exemptions). Over the five years after enactment, individual income taxes would be reduced about 6.4 percent below the current law level, as a result of a shift of tax to corporations. This shift would reverse the decline that has occurred since 1980 in the corporate income tax as a percent of GNP.

B. Administration Proposals

Table 1
Proposed Administration Revenues 1/
(Fiscal years; $ billions)

	1986	1987	1988	1989	1990	1991
Current Law Revenues2/	776.5	844.1	927.3	989.2	1053.0	1120.2
Proposals and Administrative Actions	+0.7	+6.3	+5.9	+6.9	+5.0	+3.9
Proposed Revenues	777.1	850.4	933.2	996.1	1058.1	1124.0
Memo: Percentage Increase in Revenues	0.1	0.7	0.6	0.7	0.5	0.3

SOURCE: Budget of the U.S. Government, fiscal year 1987, administration estimates.

1/ Total revenues (on- and off-budget) are included.
2/ Includes extension of taxes earmarked for trust funds like Superfund, highway, airport and airway use.

Table 2
Proposed Revenues by Source 1/
(Fiscal years, $ billions)

	1986	1987	1988	1989	1990	1991
Individual income taxes	353.7	386.0	425.9	455.5	482.0	516.3
Corporate income taxes	70.9	86.7	101.2	111.8	119.7	125.6
Social insurance taxes and contributions	280.4	302.8	335.0	358.1	384.1	407.7
Excise taxes2/	34.6	35.2	33.4	32.7	33.2	33.6
Estate and gift taxes	6.1	5.7	5.4	5.1	5.4	5.8
Customs duties	12.4	12.9	13.6	14.1	14.7	15.4
Miscellaneous receipts	19.0	21.1	18.7	18.7	19.0	19.6
TOTAL	771.1	850.4	933.2	996.1	1058.1	1124.0

SOURCE: Budget of the U.S. Government, fiscal year 1987, administration estimates.

1/ Total revenues (on- and off-budget) are included.
2/ Excise amounts include oil windfall profits tax.

Table 3
Administration Revenue Proposals
(Fiscal years, $ billions)

	1986	1987	1988	1989
1. Renewed administration proposals from 1984, 1985, and 1986 budgets				
Tax incentive for higher education savings accounts	--	-0.0	-0.2	-0.3
Tuition tax credit	--	-0.4	-0.6	-0.9
Petroleum overcharge restitution funds	--	+1.0	--	--
Increased Federal employee and District of Columbia contributions toward retirement	--	+0.9	+1.2	+1.3
IRS staff and automation increases	--	+0.9	+2.3	+3.8
Accelerated state deposits of payroll taxes	--	+0.4	+0.3	+1.2
IRS cost of collection charge	--	+0.3	+0.4	+0.4
Increased taxes earmarked for black lung disability fund	--	+0.2	+0.2	+0.2
Nuclear Regulatory Commission user fees	--	+0.2	+0.2	+0.2
Railroad unemployment insurance	--	+0.1	+0.1	+0.1
Increased hazardous substance response trust fund (i.e. superfund) revenue	--	+0.1	+0.1	+0.1
Taxation of railroad retirement benefits	--	--	+0.1	+0.1
Other, including IRS	-0.1	+0.5	-0.2	-1.0
2. New Policy Initiatives				
Extension of the 16 cents per pack cigarettes tax	+0.8	+1.7	+1.7	+1.7
Repeal gasohol and bus motor fuel tax exemptions	--	+0.2	+0.2	+0.2
Reduced Federal financing for a portion of "windfall" benefits paid to retired railroad employees	--	+0.1	+0.1	+0.1
TOTAL*	+0.7	+6.3	+5.9	+6.9

*Detail may not add to totals due to rounding.

SOURCE: Budget of the U.S. Government, fiscal year 1987, administration estimates.

1. Renewed Administration Proposals from Prior Years' Budgets

Revenue Loss Items:

Tax Incentive for Higher Education Savings Accounts

The administration proposes a higher education tax incentive that would permit families with adjusted gross income up to $40,000 to exclude from taxable income earnings on deposits of up to $1,000 per child per year for the payment of future higher educational expenses. Families with adjusted gross incomes above $40,000 could deposit progressively smaller amounts up to a maximum income of $60,000. This proposal is estimated to decrease revenues by less than $50 million in fiscal year 1987, $0.2 billion in fiscal year 1988 and $0.3 billion in fiscal year 1989.

Tuition Tax Credit

The administration proposes a tuition tax credit of up to $300 per dependent, phased in over a three-year period. This would be available in full to families with adjusted gross incomes of less than $40,000, with a phase-out up to incomes of $60,000. This proposal would allow taxpayers to receive a tax credit of 50 percent of tuition costs per child in a nonpublic school, up to the legislated maximum. This is estimated to decrease revenues by $0.4 billion in fiscal year 1987, $0.6 billion in fiscal year 1988 and $0.9 billion in fiscal year 1989. Such a proposal was defeated in the Senate in 1984.

Revenue Gain Items:

Petroleum Overcharge Restitution Funds

The Emergency Petroleum Allocation Act of 1973 permits petroleum purchasers to recover price overcharges. The courts have been handling these claims and in some cases funds from petroleum companies have been put into escrow to settle claims. The administration proposes to alter the current system of settlement and adjudication to have the effect of allocating to the Federal government overcharges which cannot readily be traced to particular victims. This proposal is estimated to raise $1.0 billion in added revenues in fiscal year 1987.

Increased Federal Employee and District of Columbia Contributions Toward Retirement

The administration proposes that Federal employee contribution to civil service retirement be increased from 7 percent of wages and salaries to 9 percent effective October 1986. This would be accompanied by an increase in the contribution of the government of the District of Columbia. These changes are estimated to increase revenues by $0.9 billion in fiscal year 1987, $1.2 billion in 1988, and $1.3 billion in 1989.

IRS Staff and Automation Increases

The administration expects higher revenues from two measures: an ncrease in staff (2,500 higher in each year from 1987 through 1989) and rovision of portable computers for IRS auditors. These proposals are stimated to raise revenues by $0.9 billion in fiscal year 1987, $2.3 billion n 1988, and $3.8 billion in 1989.

Accelerated State Deposits of Payroll Taxes

The administration proposes conforming the Social Security tax deposit requirements for states and local governments to the private sector schedule over a three year period beginning October 1,1986. Late deposits would be subject to the same penalty. The result would be increased revenues of $0.4 billion in fiscal year 1987, $0.3 billion in fiscal year 1988 and $1.2 billion in fiscal year 1989.

IRS Cost of Collection Charges

The administration proposes to replace the current penalty charges on late tax payments that are based on prevailing interest rates. New penalties would be more closely tied to IRS collection costs. The proposal would apply to returns due on or after January 1, 1987, and is estimated to raise $0.3 billion in fiscal year 1987, and $0.4 billion in each of the fiscal years 1988 and 1989.

Increased Taxes Earmarked for Black Lung Disability Benefit

The administration is proposing an increase in the fee on coal production in order to freeze the growing deficit in the Black Lung Disability fund, which would improve trust fund receipts by $0.2 billion in fiscal year 1987 and $0.3 billion in fiscal years 1988 and 1989. Because of collateral losses of other tax revenue, total net revenues would rise by $0.2 billion in each fiscal year.

Nuclear Regulatory Commission User Fees

The administration is proposing that the NRC impose fees varying with generating capacity on all operating nuclear power plants. It is estimated that the revenue gain would be $0.2 billion annually beginning in fiscal year 1987.

Railroad Unemployment Insurance

The administration proposes to extend regular Federal/State unemployment insurance coverage to railroad employment, ending the current special railroad sickness and unemployment insurance system. It is estimated this proposal would increase revenues by $0.1 billion in each of fiscal years 1987-1989.

Hazardous Substance Response Fund Revenues

The administration proposes extending and expanding the taxing authority under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (Superfund). The administration budgets a level of superfund taxes to

pay for reauthorization of superfund spending at approximately a $1.1 billion per year level of budget authority. Relative to the administration's current services baseline and after accounting for collateral losses of income tax revenue, the administration estimates a net increase in total revenues of $0.1 billion in each year 1987-1989.

Taxation of Railroad Retirement Benefits

Effective January 1, 1987, the administration proposes that all railroad retirement benefits in excess of equivalent social security benefits be taxed as ordinary income. Benefits equivalent to social security would be taxed in the same way as social security benefits are now taxed. The estimated revenue gain is $0.1 billion in each fiscal year, 1988 and 1989.

Other, Including IRS

The administration again proposes fees for IRS letters of determination and private letter rulings. These fees, to become effective October 1, 1986, are estimated to raise revenues by less than $0.1 billion in each year beginning in 1987. The "other" category includes an increase in the inland waterway diesel tax, further IRS initiatives, and the loss of Federal employees' retirement contributions and social security receipts as a result of the administration's Federal pay proposal.

Deferred Proposals

The text of the budget document affirms administration support for enterprise zones. The administration will repropose enterprise zones once tax reform is enacted. Within the context of tax reform, the administration also affirms its support for higher Individual Retirement Account limits for spouses not working outside the home, and for renewal of the Research and Experimentation business tax credit. Another previous revenue proposal, taxation of employer-paid health insurance premiums, was also incorporated in an administration tax reform package, which the administration does not consider a budget item since it is revenue-neutral overall.

2. New Initiatives

Extension of 16 Cents Per Pack Cigarettes Tax

The administration supports extension of the 16 cent tax that was increased from the 8 cent level by the 1982 tax act, an increase which expires in March 1986. Extension is estimated to raise $0.8 billion in 1986 and $1.7 billion in each subsequent year.

Repeal Gasohol and Bus Motor Fuels and Tire Tax Exemptions

Effective October 1, 1986, the administration would eliminate gasohol's 5 cent exemption from the 9 cents per gallon excise tax on motor fuel, the complete exemption for certain alcohol fuels, and the exemptions for private bus operations from the existing tire and motor fuel taxes. It is estimated that these changes will increase revenues to the highway trust fund by $0.6 billion in fiscal year 1987, and $0.7 billion in each year, 1988-1989. As a result of collateral losses in other tax revenues, the net revenue gains are $0.2 billion in each year, 1987-1989.

Reduced Federal Financing for "Windfall" Benefits Paid to Retired Railroad Workers

When railroad retirement and social security were merged certain retirees were protected from loss of benefits. The amourts paid to prevent those losses are called "windfall benefits." The administration proposes a reduction in Federal funds support for the costs of paying windfall benefits from 100 percent to the 75 percent level. Instead, a tax would be levied on the railroad industry. It is estimated that revenues will go up by $0.1 billion in each year, 1988-1989.

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C. Analysis of Revenue Policy

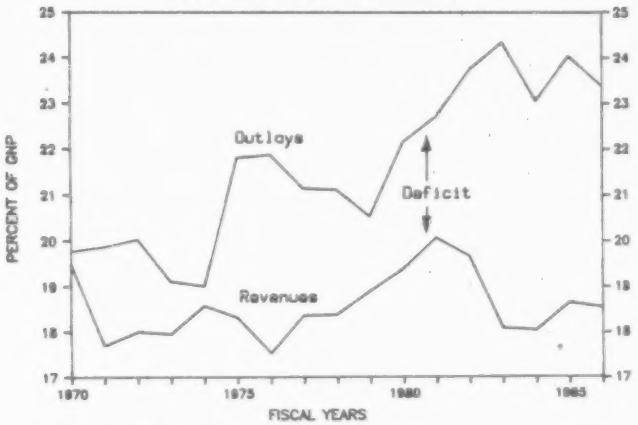
Paying for Government

The purpose of the tax system is to pay for the cost of government now rather than later. The alternative to financing with taxes is to borrow. However, borrowing to pay for government harms interest rate-sensitive sectors of the economy: exports, durable consumer goods, housing, and production that competes with imports. Borrowing merely postpones the bills until larger actions must be taken later to get control of budget deficits.

Figure 1 shows total revenues and total spending as a share of GNP from 1970 through 1986. The gap between spending and revenues is clear. This gap has opened even though nondefense spending (excluding debt service) has been cut from 15.2 percent of GNP in 1980 to 13.7 percent in 1986, a reduction equivalent to $63 billion. The President's budget proposes to close this gap by substantial additional cuts in non-military spending rather than by raising revenue.

Figure 1

TOTAL OUTLAYS AND REVENUES



SOURCE: President's Budget and Historical Data

Adequacy of Non-Social-Security Revenues

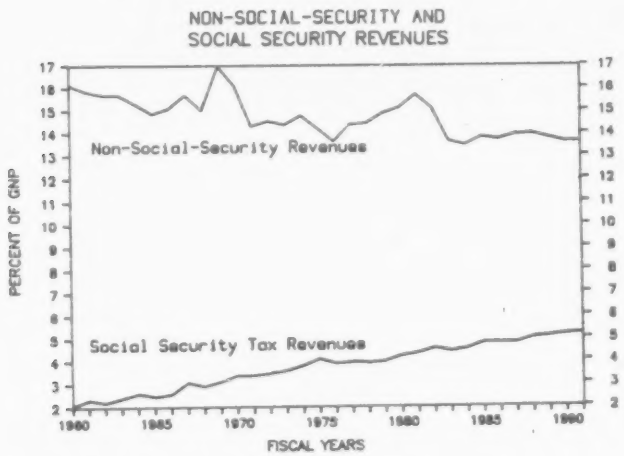
The problem of paying the government's bills is not spread across the entire budget. "Social insurance" programs such as social security and Medicare, and other "trust fund" programs like highway grants have their own earmarked tax sources. These programs have largely been "paying their own way" and will continue to do so throughout the 1980s. The deficit problem is concentrated on the side of general taxes and the large range of programs (defense and nondefense) that are financed from general taxes. Since 1980, tax increases have been enacted to pay for social security benefits and highway transportation, but not to pay for increases in general spending driven by defense increases and debt service.

The administration argues that revenues should not be increased because they are as large a share of GNP as in the 1960s and 1970s, and tax burdens should not be increased. However, revenues for purposes other than social security (OASDI) have fallen and will be lower than in the 1960s and 1970s.

The administration budget does not cut social security or its tax, but it expects the Congress to sustain a military buildup, pay greatly increased debt service, and yet bring the non-social-security budget in line with much reduced non-social-security revenues.

Figure 2 shows the thirty year decline in non-social security (OASDI) tax revenue and the increase in the social security (OASDI) taxes that have now displaced revenues available for the rest of the budget.

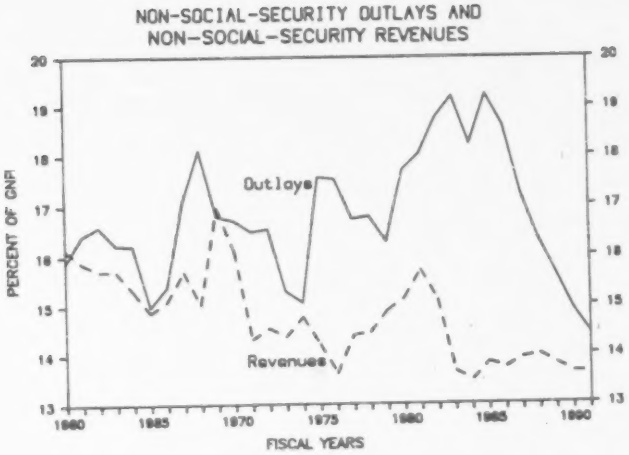
Figure 2



SOURCE: President's Budget and Historical Data

Figure 3 shows the long-term decline in non-social-security tax revenues that continues under the President's budget, the 1960-1985 rise in non-social-security spending, and the President's recommendation to drive this spending down to the diminished level of non-social-security revenues. This is to occur while military spending is sustained. From 1960 to 1985, non-social-security revenues have fallen from 16.1 percent of GNP to 13.7 percent. Over the same period, non-social-security spending rose from 15.9 percent of GNP to 19.3 percent. Recently, from 1980 through 1985, this spending increase occurred despite cuts in non-social-security domestic spending, excluding debt service.

Figure 3



Changes in Family Tax Burdens

The 1981 income tax cut reduced Federal revenues. Nevertheless, some say that family taxes are too high today in spite of the four-year income tax rate cuts enacted in 1981. Table 4 shows the income and tax status from 1980 through 1984 for a couple with median family income and two children. Table 4 accounts for both the individual income tax and the employee share of the payroll taxes for social security and medicare.

Table 4

Median Family Income and Taxes
(Current dollars)

	Income	Individual Income and Employee Payroll Tax	After-tax Income
1980	23,141	4,103 (17.7 percent)	19,038
1981	25,065	4,740 (18.9 percent)	20,325
1982	26,019	4,673 (18.0 percent)	21,346
1983	27,286	4,696 (17.2 percent)	22,590
1984	29,612	5,102 (17.2 percent)	24,510

SOURCES: Effective income tax rates for 1980-1983 from Making Choices, Joseph J. Minarik, The Urban Institute, 1985. Each family was assigned the average percent deductions claimed by all families at the same income level. Adjusted Gross Income is set equal to total income. HBC computed the effective payroll tax rates and the 1984 effective income tax rate using the latest Census data on median income. (Current Population Survey Reports, Series P-60, U.S. Bureau of the Census).

Table 4 shows that both taxes and after-tax income rose over the period. The data should, however, be corrected for inflation. A dollar of tax in 1984 is less of a burden than in 1980, because inflation has eroded the purchasing power of a dollar. Table 5 shows the adjusted data in constant 1980 dollars.

Table 5

Median Family Income and Taxes
(1980 Constant dollars)

	Income		Individual Income and Employee Payroll Tax		After-tax Income	
1980	23,141		4,103		19,038	
1981	22,985		4,339		18,606	
1982	22,532	+2.5%	4,047	-0.4%	18,485	+3.1%
1983	22,749		3,915		18,834	
1984	23,710		4,085		19,625	

SOURCES: Table 4 and inflation-adjustment calculated by HBC using the personal consumption GNP deflator.

The inflation-corrected figures do show that a median income family has about the same real tax burden in 1984 as 1980. (It is also true that this family experienced a small increase in real after-tax income, because it was able to keep its increases in real pre-tax income.)

However, above median income families have clearly received a tax cut over the four year period and a significant increae in after-tax income. The dollar benefits of the 1981 tax act were tilted toward upper-income families who were also partly protected from payroll tax increases by the statutory cap on taxable earnings. Table 6 shows the status of families with three times the median income level. In real terms, taxes fell 5.5 percent over four years, and after-tax income rose almost 12 percent.

Table 6

Three Times Median Family Income and Taxes 1/

	Current Dollar			Current 1980 Dollars				
	Income	Taxes	After-tax Income	Income		Taxes		After-tax Income	
1980	66,423	17,906 (27.0%)	48,517	66,423		17,906		48,517	
1981	75,195	20,721 (27.6%)	54,474	68,834		18,968		49,866	
1982	78,057	19,796 (25.4%)	58,261	67,597	+7.1%	17,143	-5.5%	50,454	+11.7%
1983	81,858	19,623 (24.0%)	62,235	68,245		16,360		51,885	
1984	88,836	21,125 (23.8%)	67,711	71,131		16,915		54,216	

SOURCES: Making Tax Choices, Joseph Minarik, and HBC calculations.

1/ Individual income tax and employee payroll tax.

Taxes were cut for upper-income families during the period of increases in government spending for the military and debt service. Furthermore, there has been a substantial decline in corporate taxes over the period. The corporate tax as a percent of GNP fell from 2.4 percent in 1980 to 1.5 percent in 1984, equivalent to about $33 billion 1984 dollars.

Shift in Individual Tax Burdens

The tax legislation enacted in 1981-1984, including large net reductions in individual and corporate income taxes and estate and gift taxes, and increases in payroll taxes, has generally shifted after-tax family resources in favor of higher-income households.

The individual income tax rate cuts enacted in 1981 at the administration's request were roughly proportional with respect to tax liability. The tax cut cumulated to a 25 to 27 percent rate reduction for the vast majority (over 80 percent) of taxpayers. However, a 25 percent cut for a $75,000 income family paying $15,000 in taxes amounts to $3,750, compared with a $100 cut for a $7,500 income family paying $400 in taxes. Such a tax cut increases the take-home income of the high-income family by 6 percent, compared with only a one percent gain for the low-income family.

The Congressional Budget Office has compared the old tax law with the 1981 law and has accounted, as well, for the inflation and "bracket-creep" that has taken place since the law was changed. Their estimates show how much 1984 taxes are reduced for different families because of the 1981 tax act and confirm the disproportionate benefits at different income levels.

Table 7
1984 Individual Income Tax Changes Per Household
Resulting from Major Provisions of the 1981 Tax Act

		Household Income (in current dollars)				
	All Households	Less than $10,000	$10,000-$20,000	$20,000-$40,000	$40,000-$80,000	$80,000-and over
Tax Cut	-1,160	-30	-290	-1,130	-2,870	-8,750
Percent Increase in After-Tax Incomes Per Household 1/	+6%	+1%	+3%	+5%	+7%	+11%

Source: CBO, "Study of Distributional Effects of Recent Tax Changes," March 29, 1984.

1/ Computed from CBO data.

The 1981 to 1984 changes that made individual taxes less progressive were exacerbated by a shift of the total tax load away from corporations and onto payroll taxes. Table 8 shows the shifts in reliance among different taxes.

In spite of 1982 tax changes that took back some of the large corporate tax cuts of 1981, the corporate tax has fallen from 40.1 percent of economic profits in 1980 to about 20 percent in 1985. The corporate tax falls more on property income (tangible and financial capital) than does the payroll tax,

which falls predominately on wage and salary income. Because property income accrues disproportionately to higher income households, displacement of the corporate tax by the payroll tax further reduces tax progressivity. A similar effect resulted from the large reduction in estate and gift taxes in the 1981 tax legislation.

Table 8

Composition of Revenues
(Fiscal Years, Percent)

	Historical				Estimated	
	1950	1960	1970	1980	1986	1991
Individual income tax	39.9	44.0	46.9	47.2	45.6	47.4
Corporate income tax	26.5	23.2	17.0	12.5	9.3	10.1
Social Insurance tax and contributions	11.1	15.9	23.0	30.5	36.1	36.3
Excises	19.1	12.6	8.1	4.7	4.3	2.6
Estate and gift taxes	1.8	1.7	1.9	1.2	0.8	0.5
Custom Duties	1.0	1.2	1.3	1.4	1.6	1.6
Miscellaneous receipts	.6	1.3	1.8	2.5	2.4	1.5

Source: Historical data and preliminary CBO baseline projections of current law.

A 1985 study by the Brookings Institute (Joseph A. Pechman, Who Paid the Taxes, 1966-1985) shows burdens on households of all federal taxes, including the payroll and corporate income taxes. Table 9 arranges households by income from the lowest 10 percent up through the highest 10 percent, and compares their 1985 and 1980 effective tax rates. The last column translates the Brookings data into the percentage change between 1980 and 1985 in after-tax income.

Overall, the percent of income left after taxes has risen by 0.6 percent. However, only the highest income 20 percent of households actually keep more of their income in 1985 than 1980; everyone else is worse off. The richest ten percent get to keep 2.9 percent more of their income, but middle-income households keep 0.5 to 1.4 percent less of their income, and the poorest ten percent of households keep 2.5 percent less of their income. In 1980 dollars, a $6,000 income household, for example, could see its after-tax income fall from $5,298 to $5,166, a 2.5 percent decrease, and a $25,000 before-tax middle-income household could see a 1 percent decrease from $21,025 to $20,825. In contrast, a $70,000 income household could see its after-tax income rise from $56,420 to $58,030 (1980 dollars), an increase of 2.9 percent.

Table 9

Effective Tax Rates of Federal Taxation, by Income Class

Income Class	Income at top of class in 1980	1980	1985	Percent change in after-tax income
Lowest Ten Percent	$ 7,300	11.7	13.9	-2.5%
Second	$11,750	12.8	14.5	-2.0%
Third	$16,533	13.6	15.0	-1.6%
Fourth	$21,200	14.8	16.0	-1.4%
Fifth	$26,100	15.9	16.7	-1.0%
Sixth	$31,100	16.3	16.9	-0.7%
Seventh	$36,850	16.6	17.0	-0.5%
Eighth	$44,850	17.8	17.8	0.0%
Ninth	$60,000	18.4	18.0	+0.5%
Highest Ten Percent	Unlimited	19.4	17.1	+2.9%
TOTAL		17.7	17.2	+0.6%

V. SPENDING POLICY BY CATEGORY

A. Impact of Gramm-Rudman

The Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman) sets deficit targets for fiscal years 1986-1991, leading to a balanced budget. Presidential and Congressional budgets are required to meet those deficit targets. If, at the start of each fiscal year, OMB and CBO estimate that the deficit will be over target, automatic spending cuts ("sequestrations") are instituted.

The President's Budget claims to meet the Act's targets in all years but fiscal 1986.

Fiscal Year	Target Deficit	President's Deficit
1986	-171.9	-202.8
1987	-144.0	-143.6
1988	-108.0	-93.6
1989	-72.0	-67.5
1990	-36.0	-35.7
1991	0.0	+1.3

CURRENT SERVICES AND DEFICIT REDUCTION

OMB prepares a "current services" baseline projection each year. The baseline is an estimate of the level of spending, revenues, and deficit that would occur if existing spending and tax laws were simply extrapolated into the future. When the President discusses spending cuts or tax increases, he is comparing his fiscal year 1987 budget proposals with his fiscal year 1987 baseline.

In general, baseline projections assume that tax laws and entitlement spending laws will continue without amendment. Discretionary appropriations generally start with the enacted 1986 level as a base, and are then adjusted for inflation each year. In the case of appropriations for national defense, however, OMB's baseline contains two atypical features. First, OMB includes 9.3% real growth in budget authority in its baseline. Therefore, the OMB baseline is almost $23 billion in budget authority higher than an "inflation only" baseline would be. Second, OMB appears to understate the outlays that would be associated with its budget authority projection by about $15 billion. By coincidence, the understatement of outlays almost exactly offsets the outlay increase that would accompany the budget authority increase. Therefore, by coincidence, the outlay level in OMB's baseline is consistent with "inflation only", although the budget authority level is not.

Compared to OMB's current services baseline, the President's budget proposes deficit reduction of $38.2 billion in fiscal year 1987 and $166 billion over three years.

OMB Baseline Deficits vs. Proposed Deficits
(In billions of dollars)

Fiscal Year	Baseline	Budget	Reduction
1986	-205.6	-202.8	2.8
1987	-181.8	-143.6	38.2
1988	-150.0	-93.6	56.4
1989	-138.9	-67.5	71.4
1990	-126.3	-35.7	90.5
1991	-103.9	+1.3	105.2

EFFECT OF 1986 SEQUESTRATION

The Gramm-Rudman Act resulted in sequestration in fiscal year 1986. A special proviso capped 1986 sequestration at $11.7 billion in outlays.

To produce the 1986 outlay cuts, sequestration reduced total budgetary resources (mostly budget authority) by more than $24 billion. In baseline projections the $24 billion reduction in budgetary resources is generally assumed to be permanent; amounts in the baseline are lower by that amount in all future years. The resulting outlay savings are approximately as follows:

Outlay Savings from 1986 Sequestration
(In billions of dollars)

	1986	1987	1988	1989	1990
Total	11	18	20	22	22
Defense	(5)	(9)	(11)	(12)	(12)
Nondefense	(6)	(9)	(9)	(10)	(10)

As noted, in its defense baseline OMB did **not** assume that the 1986 sequestration would be a permanent reduction in defense funding levels (although they **did** assume a permanent reduction in nondefense funding levels). Therefore, only the nondefense sequestration lowered OMB's baseline projections. In other words, without 1986 sequestration OMB's 1987 baseline deficit would have been higher by $9 billion, and therefore would have been about $191 billion.

POSSIBLE 1987 SEQUESTRATION

For fiscal year 1987 the President has proposed deficit reduction of $38.2 billion as compared to OMB's baseline, resulting in a deficit of $143.6 billion. **Given OMB's apparent understatement of military outlays, the President's budget would not be in compliance with the Gramm-Rudman deficit ceilings.** In order to meet those ceilings, greater reductions than shown below would be necessary.

Net Revenue Increase	$ 6.3	billion
Net Outlay Reductions	31.9	billion
Total Deficit Reduction	38.2	billion

The President opposes using across-the-board sequestration. His Budget Message states:

> We should avoid such across-the-board cuts in the future, and they will not be necessary if Congress adopts this budget. Achieving budget savings by taking into account relative priorities among programs is a much better way than resorting to an arbitrary formula.

Nonetheless, if for fiscal year 1987 Congress and the President are unable to agree on a 1987 budget, but instead simply allow spending and revenues to continue at baseline levels, then the Gramm-Rudman Act will result in automatic sequestration of $37.8 billion to reach the deficit target of $144.0 billion, given OMB estimates. It should be noted that economic and spendout estimates made in January are often revised in August, sometimes substantially, so that sequestration could be quite different from the below display. (Additional debt service savings will also be produced.)

Potential 1987 Sequestration
(Outlays in billions of dollars)
(If based on OMB Current Services Projections)

COLA freeze	-1.1
"Special Rules"	-1.6
Defense	-18.4
Nondefense	-16.7
SEQUESTRATION	-37.8
Debt Service	-1.9
TOTAL	-39.7

- COLAs for Federal Civil Service, Military, and similar retirees would be frozen, for a savings of $1.1 billion.

- Medicare and other "special rule" health programs would be cut by 2 percent, for a savings of about $1.6 billion.

- Defense budget authority and unobligated balances would be reduced by 10 percent, or $37 billion, producing an outlay savings of $18.4 billion. Defense budget authority for fiscal year 1987 would be reduced from $320 billion to $283 billion, about $3 billion below the 1986 level.

- Nondefense programs (other than exempt and "special rule" programs) would be cut by almost 15 percent, for outlay savings of $16.7 billion.

- Taxes would not be affected by sequestration.

CBO BASELINE VS. OMB BASELINE

CBO also prepares a baseline projection. CBO and OMB use similar baseline concepts and estimates in almost all areas except defense. CBO's baseline adjusts 1986 appropriations (both defense and domestic) for inflation. As noted previously, OMB's baseline includes 9.3 percent real growth on top of inflation for defense, but apparently does not reflect the resulting outlay increase.

A baseline that (1) did **not** include real budget authority growth in defense, and (2) did use CBO defense spendout estimates, would still show a deficit of about $180 billion.

If Congress and the President are unable to agree on deficit reduction proposals, but instead enact legislation consistent with this "inflation only" baseline, then CBO would probably estimate that the Gramm-Rudman Act would require automatic sequestration of about $36 billion in outlays. This presumes that CBO's January estimates prove accurate in August.

The critical difference between this scenario and the previous scenario is that defense budget authority would be significantly lower in this case. In fact, defense budget authority would be about $268 billion, which is $18 billion below the fiscal year 1986 level and $52 billion below the President's request.

B. Military Spending

The administration's request for the National Defense function for fiscal year 1987 continues the extraordinary funding build-up reflected in fiscal years 1981-1986. Total defense budget authority requested for fiscal year 1987 is $320.3 billion as compared with the fiscal year 1980 level of $145.8 billion. The cumulative funding for the five fiscal years 1981-1985 is $1.2 trillion. This compares to the cumulative funding for the five fiscal years 1976-1980 of $589.8 billion ($0.6 trillion). **For the six fiscal years 1986-1991 the National Defense budget is projected by the Administration to total $2.10 trillion.** Of this $2.1 trillion defense program, $763 billion is directed to the Investment accounts (Procurement, R&D, Construction). These accounts have very low spendout rates in the first year with significant outlays taking place in the outyears. As defense program growth continues, outlay growth in the outyears thus becomes very difficult to control. Fiscal year 1987 defense outlays are estimated by the President to be $282.25 billion, an increase of $16.45 billion over fiscal year 1986.

It appears the administration has underestimated outlays in all years. The estimate for fiscal year 1986 is below the CBO current level by approximately $4 billion. Fiscal year 1987 outlays may be underestimated by as much as $15 billion. Total outlays in the years 1986-1991 may be underestimated by as much as $50-$60 billion.

The following displays the growth of defense programs and their relationship to the total Federal budget and the Gross National Product based on the administration's data and assumptions:

- Real Growth (budget authority)

FY 1980	FY 1981	FY 1982	FY 1983	FY 1984
2.1%	12.7%	12.3%	9.1%	5.3%

FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
7.3%	-5.9%	8.3%	3.0%	2.9%

- Nominal Growth (budget authority)

FY 1980	FY 1981	FY 1982	FY 1983	FY 1984
13.8%	25.1%	20.3%	13.2%	8.2%

FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
11.1%	-2.9%	12.0%	6.6%	6.4%

- National Defense Outlays as Percentage of Gross National Product

FY 1980	FY 1981	FY 1982	FY 1983	FY 1984
5.0%	5.3%	5.9%	6.3%	6.2%

FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
6.4%	6.3%	6.2%	6.1%	6.1%

- National Defense Outlays as Percentage of Federal Budget outlays

FY 1980	FY 1981	FY 1982	FY 1983	FY 1984
22.7%	23.2%	24.8%	26.0%	26.7%

FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
26.7%	27.1%	28.4%	29.1%	30.3%

The following displays the administration's request by activity and title for fiscal years 1980-1987.

Budget Authority by Activity and Title

(In billions of dollars)

	1980	1983	1984	1985	1986	1987
Military Personnel.....	41.1	61.1	64.9	67.8	67.7	74.2
Operations and Maintenance..	46.4	66.5	71.0	77.8	74.9	85.8
Procurement.....	35.3	80.4	86.2	96.8	92.6	95.8
Research, Development, Test and Evaluation.....	13.6	22.8	26.9	31.3	33.7	41.9
Military Construction.....	2.3	4.5	4.5	5.5	5.3	6.8
All Other.....	2.0	3.4	4.7	7.6	4.2	3.8
Allowance for Pay Raise.....	...	...	...	...	...	3.3
Total (Function 051).....	(140.7)	(238.7)	(258.2)	(286.8)	(278.4)	(311.6)
Atomic Energy Defense Activities (Function 053).	3.0	5.7	6.6	7.3	7.2	8.2
Defense Related Activities (Function 054).....	0.2	0.6	0.4	0.6	0.5	0.5
Total National Defense (Function 050).....	143.9	245.0	265.2	294.7	286.1	320.3

- Fiscal Year 1987 Budget Request

The administration's fiscal year 1987 budget request reflects continued significant increases in the areas of procurement and of research and development for weapons systems. For fiscal year 1987 the funding requested in these areas is $137.75 billion or 43 percent of the Defense budget and represents an increase of $11.40 billion or 9.0 percent over the fiscal year 1986 levels. Additionally, the Military Construction accounts increase by $1.45 billion (27.7 percent). Increased funding in these areas results in relatively minor outlay increases in fiscal year 1987. However, the impact on the outyear outlays is significant, and once contracts are signed, outlays become **very difficult for both subsequent administrations and Congresses to control.** It is significant to note the funding profiles for procurement, research, and military construction from 1980 through fiscal year 1989 as compared to the total defense budget requests. The following table shows the increasing amount of the total defense budget allocated to investment programs.

Budget authority
(In billions of dollars)

	Total National Defense	Procurement, Research, Construction	Percentage of Total
Fiscal year 1980	143.9	51.2	36%
Fiscal year 1981	180.0	68.1	38%
Fiscal year 1982	216.5	89.4	41%
Fiscal year 1983	245.0	107.7	44%
Fiscal year 1984	265.2	117.5	44%
Fiscal year 1985	294.7	133.7	45%
Fiscal year 1986	286.1	131.7	46%
Fiscal year 1987	320.3	144.5	45%
Fiscal year 1988	341.6	153.5	45%
Fiscal Year 1989	363.2	162.4	45%

- Inflation

The Department of Defense is projecting inflation to average nearly three percent for the period 1987-1991. These projections are lower than some other widely accepted forecasts for defense inflation.

- Real Growth

The fiscal year 1987 request, if enacted, would represent the seventh year in the preceding eight years that there would be real growth in defense budget authority. Continued real growth for this number of years and to the extent provided (i.e., some years providing double digit real growth) is unprecedented in the peacetime history of this nation. Real growth since 1981 has averaged over six percent per year, is projected in fiscal year 1987 to be over eight percent, and would grow by approximately three percent per year in the outyears.

Early in the present administration it was argued that a defense build-up was required to make up for years of neglect. But now, after a sustained period of unprecedented growth to the defense budget, the need for continued real increases year after year is questioned by many experts.

The compounding effects of continued real growth means that even relatively small percentage real growth increases after the substantial growth of the last several years translate to significant dollar increases into the defense budget. As a result of the growth in the size of the base for computing real growth, each percent of real growth in fiscal year 1987 is nearly $3 billion, whereas in fiscal year 1980 each percent of real growth was approximately $1.5 billion.

Additionally, in computing real growth, the computation often includes all portions of the defense budget, including pay and pay related areas. The application of real growth to these areas is improper because funding is determined based on personnel levels and applicable pay raises.

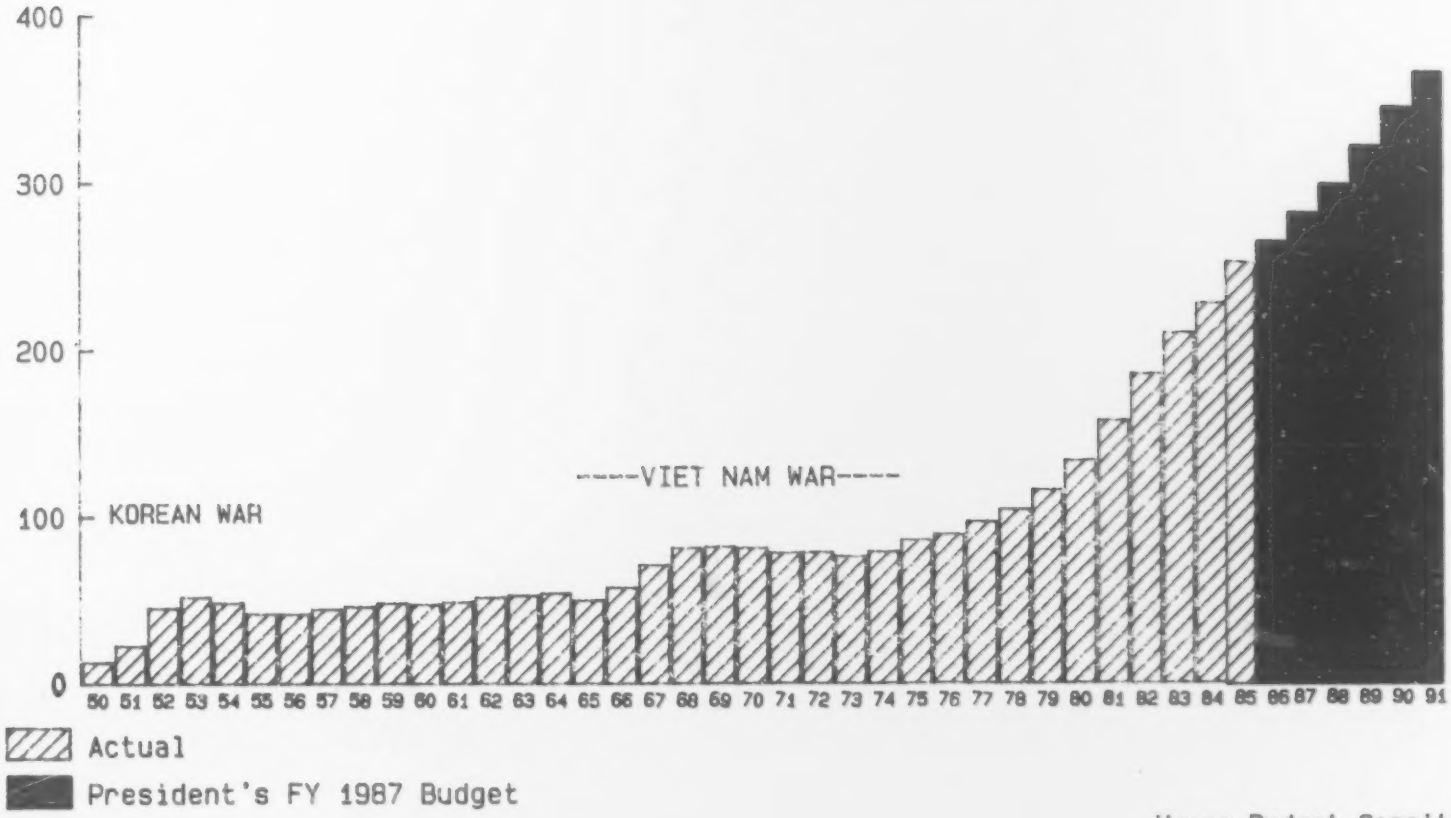
When real growth is computed on the defense budget as a whole (i.e. including pay and pay related areas which will receive less than the real growth being computed) it translates to more than the across-the-board real growth being given in program areas. For example, three percent overall real growth for defense would actually translate to less than three percent real growth in the pay areas (as explained above) and to more than three percent in the defense nonpay programs.

Defense Funding Level

Comparisons displaying defense spending as a percent of GNP or percent of the Federal budget are often made to support higher defense funding. These comparisons are less than useful in determining the appropriate level of current defense requirements. It is not necessarily appropriate to designate some point in time as an optimum level of defense spending (as a percent of GNP or Federal budget) and make comparisons to that level. **The level of defense funding should ultimately be decided by determining what is required to meet our national security objectives, not by choosing a funding level based on an arbitrary level or percent of GNP.**

Much is being made of the fact that the fiscal year 1986 defense budget was reduced, through sequestration, to a level below the fiscal year 1985 actual. It is important to remember, however, that the fiscal year 1986 post-sequestration level of $286.1 billion is still 45 percent, in real terms, above the fiscal year 1980 level.

MILITARY SPENDING OUTLAYS
1950 – 1991
(In billions of dollars)



House Budget Committee
February 5, 1986

C. Entitlements

The budget proposes entitlement outlay savings in fiscal year 1987 of $9.00 billion below the preliminary CBO baseline and $7.40 billion in outlays below the OMB current services estimates.

Medicare

The largest single savings is medicare in which the budget proposes legislative savings of $2.95 bilion and regulatory savings of $1.75 billion. The savings would come from higher medicare premiums, deductibles and copayments and from reductions in payments to hospitals, doctors and other providers. More detail on these reductions is found in the Major Issues section of Function 570: Medicare.

Low-Income Programs

The aggregate reduction in spending for low-income programs would be $2.55 billion from proposed legislative changes and another $1.7 billion from lower estimates than CBO projects in the preliminary baseline. Some of the lower estimates reflect the budget plan to impose fiscal sanctions on States for erroneous payments in means-tested assistance programs. Specific low-income reductions include:

- Medicaid -- Legislative reductions of $1.15 billion and plus current law funding of $0.55 billion below the preliminary CBO baseline. The budget proposes to change the open-ended entitlement nature of the program and implement regulatory and administrative actions.

- Food Stamps -- Legislative reductions of $0.30 billion and plus current law funding of $0.40 billion below the preliminary CBO baseline. The largest source of these savings would be fiscal sanctions against States for erroneous payments.

- AFDC -- Legislative reductions of $0.25 billion plus current law funding of $1.05 billion below the preliminary CBO baseline. These legislative proposals are similar to ones which the Congress did not accept when proposed in previous budgets. The reduction in current law funding could result in States lowering benefits.

- SSI -- The Reagan budget proposes to save $34 million in outlays in fiscal year 1986 through elimination of duplicate benefits.

- Child Nutrition -- Legislative reductions of $0.70 billion are proposed primarily from ending the subsidy given to non-needy children in school lunch programs. This reduction could jeopardize nutrition assistance to needy children, if schools drop the program because of the cut.

- Vocational Rehabilitation -- Legislative reductions of $0.10 billion are proposed through capping the basic State grant program at $1.1 billion in fiscal year 1987.

Federal Military and Civilian Retirement

Legislative savings of $1.15 billion are assumed in Federal civilian and military retirement programs in fiscal year 1987. The largest source of the fiscal year 1987 savings would come from continuation for a second year of the cost-of-living adjustment (COLA) freeze. Significant long-term savings would occur from structural changes to civil service retirement which the Reagan administration proposes. In general, these structural change proposals are similar to previously transmitted budget reductions.

Farm Price Supports

The budget includes a legislative initiative to increase the guarantee fee for Commodity Credit Corporation (CCC) short export credit guarantees from less than one percent up to five percent. This guarantee fee increase is estimated to reduce net CCC spending by $140 million in 1987. The administration proposes no change in current law price support loan rates or target prices.

Guaranteed Student Loans (GSL)

Legislative savings of $0.85 billion are assumed in fiscal year 1987 primarily by eliminating interest subsidy paid by the Federal Government while a student is attending a post-secondary institution, requiring a needs analysis test for all GSL applicants and recalling all Federal advances provided to State guarantee agencies.

The following table provides outlay estimates by program of the entitlement changes proposed in the budget.

MAJOR ENTITLEMENT PROGRAMS
(Outlays in billions of dollars)

	1985	1986	President's 1986 Request			1987	President's 1987 Request		
	Actual	CBO Baseline (Prelim.)	Current Services	Proposed Reductions	Net Program Costs	CBO Baseline (Prelim.)	Current Services	Proposed Reduction	Net Program Costs
A. Low-Income									
Medicaid	22.65	24.45	24.70	...	24.70	26.45	25.90	-1.15	24.75
Food Stamps	12.50	12.60	12.55	-0.05	12.50	13.05	12.65	-0.30	12.35
AFDC	8.60	9.10	9.05	...	9.05	9.50	8.45	-0.25	8.20
SSI	9.60	10.20	10.15	...	10.15	10.40	10.55	-0.05	10.50
Veterans' Pensions	3.85	3.80	3.85	...	3.85	3.75	3.85	...	3.85
Child Nutrition	3.65	3.90	3.85	...	3.85	4.15	4.20	-0.70	3.50
Earned Income Tax Credit	1.10	1.30	1.30	...	1.30	1.25	1.25	...	1.25
Vocational Rehabilitation State Grant	0.70	1.00	1.30	-0.05	0.00 1.25	1.15	1.15	-0.10	0.00 1.05
Subtotal: Low-Income	62.65	66.35	66.75	-0.10	66.65	69.70	68.00	-2.55	65.45
B. Social Security	188.60	199.40	200.05	...	200.05	211.40	212.20	...	212.20
C. Unemployment Compensation	17.45	16.45	16.50	...	16.50	16.75	16.90	*	16.90
D. Medicare	65.80	69.15	68.65	...	68.65	71.85	73.20 **	-2.95	70.25
E. Retirement and Disability					0.00				
Civil Service Retirement	23.10	23.90	24.05	...	0.00 24.05	25.15	25.40	-0.65	24.75
Military Retirement	15.80	17.60	17.65	...	17.65	18.35	18.50	-0.50	18.00
Veterans' Compensation	10.25	10.40	10.45	...	10.45	10.60	10.40	0.30	10.70
Railroad Retirement	3.75	3.85	3.80	...	3.80	3.80	3.75	0.05	3.80
Subtotal: Retirement and Disability	52.90	55.75	55.95	...	55.95	57.90	58.05	-0.80	57.25
F. Other Programs									
Farm Price Supports	17.70	24.90	20.35	...	20.35	14.60	16.35	-0.15	16.20
State Local/Fiscal Assistance	4.55	4.40	2.65	0.70	2.65	4.15	...	...	...
Veterans' Readjustment Benefits	1.10	0.65	0.65	...	0.65	0.65	0.55	...	0.55
Guaranteed Student Loans	3.55	3.40	3.30	-0.05	0.00 3.25	3.30	3.40	-0.85	2.55
Child Support Enforcement	0.60	0.65	0.65	...	0.00 0.65	0.75	0.75	-0.05	0.70
Family Social Services	0.55	0.55	0.60	...	0.00 0.60	0.60	0.65	-0.05	0.60
Social Services (Title XX)	2.75	2.60	2.60	...	0.00 2.60	2.70	2.70	...	0.00 2.70
Subtotal:	30.80	37.15	30.80	0.65	30.75	26.75	24.40	-1.10	23.30
TOTAL:	418.20	444.25	438.70	-0.15	438.55	454.35	452.75	-7.40	445.35

* Less than $25 million.
** The Reagan budget current services estimate for medicare also includes $1.75 billion in regulatory changes.

Non-Defense Discretionary Programs

In 1987, non-defense discretionary programs represent about 15 percent of the budget. The share of the Federal spending for non-defense discretionary programs has declined from 24 percent in 1980.

The President's budget proposes changes in domestic programs for fiscal year 1987 that would result in spending reductions of $28 billion when compared to the administration's "current services" baseline projections or $21 billion when compared to 1986 levels. Additional reductions of $3.3 billion are proposed in fiscal year 1986.

Between 1987 and 1991 these policy changes would reduce the deficit by about $264 billion compared to the "current services" baseline. These cuts would be achieved though a broad range of proposed program terminations, reductions, shifts in responsibilities to either the private sector or State and local governments and user fees.

- Program Terminations -- The President's budget proposes to terminate 40 programs which are viewed as "ineffective, duplicative or unnecessary". Major proposals include: eliminating Revenue Sharing, Ex-Im Bank direct loans, SBA loans, EDA, ARC, UDAG, WIN, Legal Services, mass transit section 3 discretionary capital grants and Washington Metro grants, Postal subsidy, Amtrak subsidy, State Maritime schools, the recent expansion of cargo preference, Title XI loan guarantees for ship construction and the new GI bill test program. (Table in Section V. D.)

- Program and Management "Reforms" -- The President's budget proposes various savings in social programs including medicare, student aid, school lunches, medicaid, AFDC, veterans medical care, refugee assistance, health professions training subsidies, Indian health care, summer youth employment, Job Corps and biomedical research grants. Additional savings are assumed from the improved management of Federal operations. (Table in Section V. D.)

- Privatization -- To reduce competition with the private sector the President's budget proposes to sell assets to the private sector or terminate Federal subsidies. Major proposals include: restricting eligibility for FHA mortgage insurance, replacing direct assistance with housing and education vouchers, selling the Naval petroleum reserves and Power marketing administrations. (Discussed in Section C. 1.)

- Federalism -- The budget proposes to transfer certain activities to state and local governments through block grants. Other grants that are not viewed as a Federal responsibility will be terminated or reduced. Examples include a new block grant for local ground transportation which result in significant reductions or elimination of certain existing highway and mass transit programs; a block grant for pollution control; phasing out assistance for sewage treatment plants and terminating community services block grants. (Discussed in VI. A. Aid to State and Local Governments)

- Charges for Government Services -- The budget proposes a number of new or expanded user fees, including: increased fees for recreation facilities and waterways and new fees for meat and poultry inspection. (Discussed in Section C. 2.)

1. Privatization

A major theme of President Reagan's 1987 budget is "privatization". The privatization proposals include the elimination of Federal activities or services which are believed to be more efficiently undertaken by the private sector and the elimination of Federal subsidies which are deemed to distort or compete with private sector services. An important part of the proposed privatization initiative is the sale to the public of physical assets and loan assets associated Federal activities to be eliminated.

In the aggregate, the administration estimates that the privatization proposals will reduce Federal spending by $6.80 billion in 1987 and $27.95 billion over the four year period 1986-1989. In addition, the budget proposes to sell loan assets with a book value of $4.4 billion in 1987. These loan asset sales would reduce the deficit by an estimated $1.75 billion in 1987 and $2.45 billion over three years, 1987-1989, below what the deficit would otherwise be. The total four year deficit reduction from these proposals would be an estimated $30.35 billion. A table summarizing these privatization proposals is attached.

Transfering Responsibilities to the Private Sector

The 1987 budget contains eight major proposals to eliminate unnecessary programs in competition with the private sector. The underlying policy assumptions of these proposals is that either there is no public benefit from continuing the Federal activity or, if there is a benefit, the Federal government should not attempt to directly provide the service involved but just subsidize private market services. The eight proposals are:

- Chapter 1 Compensatory Education Vouchers - The budget proposes to allow parents of educationally disadvantaged students the option to receive vouchers that may be used to procure private education or education in other school districts rather than to receive the compensatory education services of their assigned districts.

- Housing Vouchers - The budget proposes to eliminate Federal involvement in the construction and financing of subsidized housing. The HUD subsidized housing and Section 202 housing for the elderly or handicapped loans and USDA rural housing loans are proposed to be eliminated and replaced with a HUD housing voucher program. Lower income tenants would use the vouchers to secure housing on the open market.

- Federal Housig Administration - The budget proposes to increase the FHA lump sum insurance premium from 3.8 percent to 5.0 percent in order to build the insurance reserves against future losses and to eliminate the subsidy received by FHA borrowers compared to private mortgage insurance. In addition, the budget indicates the administration will study options for the sale of the FHA to the private sector.

- Export-Import Bank Loans - The budget proposes that the Ex-Im Bank will borrow funds from the private credit market in order to finance export loans rather than using Federal funds. The budget also requests a new $100 million interest subsidy appropriation to offset the higher cost of private financing.

- Overseas Private Investment Corporation - The budget indicates that a study will be conducted on how to turn over to the private sector the export loan and insurance activities of OPIC. The budget indicates that privatization of OPIC and termination of its loan activity would occur in 1989.

- Federal Crop Insurance - The budget proposes again to phase out Federal subsidies for crop insurance against losses from natural disasters over five years. In addition, the budget proposes a new user fee to offset the direct Federal costs of overseeing and regulating the program.

- Amtrak - The budget proposes termination of the Federal subsidy for Amtrak in 1987, which is estimated to be $613 million in the preliminary 1987 CBO baseline. The Reagan administration believes Amtrak traffic can be absorbed by other railroads or other modes of transit.

- LANDSAT Subsidy - The budget proposes to discontinue subsidies for land remote sensing satellites. The costs of these satellite services are to be fully paid by the users.

ıle of Physical Assests

The budget includes four major proposals to divest the Federal Government activities and assets which are deemed to be better performed by the ivate sector or to be surplus. The sales of physical assets can take veral years to accomplish. These sales provide large, one-time reductions the budget deficit. These reductions may, however, be offset in future ars by losses of income from the assets. The economic efficiency or social lue of the proposed sales must be determined on a case-by-case basis. The ur physical asset sales proposals are:

- Power Marketing Administrations - The budget proposes to sell over a period of several years the five regional power marketing administrations owned by the Department of Energy. They are the Bonneville, the Southwestern, the Southeastern, the Western, and the Alaska Power Administrations. The first privatizations are expected to occur in 1988.

- Naval Petroleum Reserves - The budget proposes to sell the Elk Hills, California, and the Teapot Dome, Wyoming, Naval petroleum reserve oil fields rather than to sell the oil as it is pumped. These reserves would be replaced by the strategic petroleum reserve (SPR). The administration believes the naval petroleum reserves are now unnecessary because of the presence of the SPR and adequate open market oil supplies.

- GSA Surplus Property Sales - The administration proposes to accelerate sales of surplus property by the GSA in 1987 and 1988. Agencies have been given specific targets for the amount of surplus property to be given to GSA for sale. The estimated receipts of $578 million in 1987 and $658 million in 1988 are about five times the annual rate of sales in recent years.

- Conrail - The budget assumes that pending legislation authorizing the sale of Conrail will be enacted in 1986. This sale is estimated to yield $1.2 billion of receipts.

Loan Asset Sales

The 1987 budget proposes that direct loans with a face value of $4.4 billion be sold to the public. The loans would be sold without any Federal guarantee or recourse. The sales are estimated to result in an average return of 46 cents to a dollar of face value. The loans to be sold are from SBA business and disaster loans, VA vendee loans, defaulted guaranteed student loans, college housing and higher education facility loans, FHA loans, USDA rural housing and rural development loans, REA electric and telephone loans, HUD rehabilitation loans, and national direct student loans.

Sales of loan assets also create large one-time reductions in the deficit under current budget scorekeeping rules. However, because the Government is also foregoing future loan repayments, future deficits will be higher than they otherwise would be. Also loan asset sales do not have the same economic benefit as a real reduction in Federal spending because the loan assets would simply substitute for Treasury securities in the portfolios of private investors and would absorb the same amount of savings as the Treasury securities would have. (See II. G. Economics of Privatization and Asset Sales for a complete discussion) Indeed, sales of loan assets could actually increase Federal interest costs slightly over time. Because the loan assets are less liquid and more difficult to trade than the Treasury securities they replace, investors are likely to demand a slightly higher yield on the loan assets, resulting in a higher net interest cost to the Federal Government.

Summary of Proposed Privatization Deficit Reductions

(In billions of dollars)

	FY 1986	FY 1987	FY 1988	FY 1989
Transfer of Activities to the Private Sector				
1. Compensatory Education Vouchers	...	+*	+0.05	-*
2. Housing Vouchers	-1.15	-3.80	-5.10	-5.85
3. Federal Housing Administration	...	-0.15	+0.10	+0.05
4. Export-Import Bank Loans	...	-0.20	-0.35	-0.45
5. Overseas Private Investment Corp.	...	-*	-*	-*
6. Federal Crop Insurance	...	-0.35	-0.45	-0.55
7. Elimination of Amtrak Subsidy	...	-0.60	-0.65	-0.65
8. Elimination of LANDSAT Subsidy	...	-0.05	-0.05	-0.05
Subtotal	(-1.15)	(-5.15)	(-6.45)	(-7.50)
Sale of Physical Assets				
1. Regional Power Marketing Admin.	...	-0.15	-1.60	-1.15
2. Naval Petroleum Reserves	...	-1.00	-1.85	+0.50
3. GSA Surplus Asset Sales	...	-0.45	-0.55	-0.20
4. CONRAIL	-1.20	...	...	...
Subtotal	(-1.20)	(-1.60)	(-4.00)	(-0.85)
Loan Asset Sales	...	-1.75	-0.75	+0.05
TOTAL	-2.35	-8.50	-11.20	-8.30

* Less than $25 million.

2. User Fees

The administration is proposing new or increased user fees consistent with the philosophy that the costs of many services provided by the Federal Government should be fully or partially recovered from the groups which benefit. These include fees for recreational, commercial, and safety services provided by the Coast Guard, and for the use of the commercial navigation facilities operated by the Corps of Engineers; additional customs fees to offset the cost of processing passengers and commercial carriers; and fees on Internal Revenue Service letters of determination and private letter rulings, and a charge to recoup the expense of collecting underpaid taxes. These and other user fees are estimated by the administration to yield $3.3 billion in 1987 and $11.4 billion over three years.

Following are the major user fee proposals included in the President's fiscal year 1987 budget.

(In millions of dollars)

Agency or Program	Deficit Reduction FY 1987	FY 1988	FY 1989
Federal Energy Regulatory Commission (FERC) User Fees.....	26	51	52
The budget proposes legislation to allow FERC to impose a user fee on those applying for FERC licenses, to partially recover the FERC's indirect costs of regulation.			
Uranium Enrichment Services.....	235	270	270
The Department of Energy sells services for enriching uranium to electric utilities so that the uranium can be used as fuel in nuclear reactors. The budget proposes to establish a formula for annual payments to the Treasury from sales revenues in order to repay unrecovered prior-year Government costs.			
Corps of Engineers Navigation User Fees.....	203	223	240
The budget proposes an ad valorem fee for use of commmercial harbors that would equal 0.04 percent (4 cents per $100) of the value of the cargo loaded and unloaded at U.S. ports, including imports and exports. In 1987, receipts from this fee would recover about $200 million or 40 percent of Corps of Engineers harbor operation and maintenance costs. The proposal also calls for doubling the existing inland barge fuel tax over 10 years through equal annual steps, resulting in a revenue increase of $50 million by 1997. This will ultimately offset about 20 percent of Corps inland waterways costs.			

(In millions of dollars)

Agency or Program	Deficit Reduction FY 1987	FY 1988	FY 1989
Recreation User Fees	126	128	133
The budget proposes legislative authority to increase entrance fees at parks with existing fees and to extend fees to other units of the National Park Service (NPS) where it is economically and otherwise feasible to charge a fee; an increase in the price of the annual pass to all parks; and inclusion of 80 percent of revenues collected in the budget for operation of the NPS, with the remaining 20 percent going to the general fund of the U.S. Treasury. For the Forest Service, the proposal will provide authority to charge user fees at up to 3,000 additional sites with recreational facilities; and allow revenues to be retained by the Forest Service for operation and maintenance of recreation programs and facilities.			
Ocean Sportfishing License Fee	20	30	50
The budget proposes an ocean Federal sportfishing license fee of $10 minimum per angler. Each coastal State would issue the license in conjunction with its freshwater fishing (or other) license program. Each coastal State participating in the program would provide $5 of the license fee to the Federal Government and could assess an additional amount to recoup the costs of administering the license program and to recover costs of fishery management by the State. States would provide the Federal Government with information on the number of licenses issued. The Federal marine license would be transferrable between States.			
Coast Guard Services	242	480	480
Once full implementation is achieved the proposed Coast Guard user fees for recreational and commercial mariners will cover about 25 percent of the Coast Guard operating budget.			
Commodity Credit Corporation (CCC) export credit	140	93	42
The budget proposes that guarantee fee for Commodity Credit Corporation guarantees of export loans be increased to five percent.			

(In millions of dollars)

Agency or Program	Deficit Reduction FY 1987	FY 1988	FY 1989
Agricultural Marketing Fees.....	43	44	44
The budget proposes to increase the scope of services now provided on a user fee basis to include compliance and standardization for Federal grain inspection, market news information and other activities of the Agricultural Marketing Service, and investigations of market fraud involving packers and stockyards.			
Animal and Plant Inspection Fee.....	21	21	21
The budget proposes user fees for services rendered through the agricultural quarantine inspection, import/export inspection, veterinary biologies and veterinary diagnostic programs.			
Federal Housing Administration Insurance.....	146	93	42
The budget proposes an increase in the premium collected by FHA for its single-family insurance from 3.8 percent to 5.0 percent. This premium is collected at the time the loan is made and can be paid in cash by the borrower or be included in the financing of the loan.			
Meat and Poultry Inspection Fee.....	366	366	366
The budget proposes to impose a user fee on meat and poultry industries that would completely support inspection costs and related expenses.			
Pension Benefit Guaranty Corporation (PBGC).....	199	214	227
The budget proposes to increase the premiums that sponsors of single-employer plans must pay the PBGC and to close legal loopholes being used by some firms to impose pension liabilities on the government.			

(In millions of dollars)

Agency or Program	Deficit Reduction FY 1987	FY 1988	FY 1989
VA Housing Loan Origination Fee.....	132	146	227
The budget proposes to increase the current one percent loan origination fee on VA guaranteed and direct housing loans to 2 percent in 1987. The fee, which could be added to the mortgage, would be increased to 3.8 percent by 1990. Veterans with service-related disabilities would continue to be exempt from the loan fee.			
IRS and Customs Fees.....	913	910	924
The budget proposes to impose user fees on IRS private letter rulings and determination letters. A schedule of fees would be constructed to reflect the complexity of the individual case and the resources required for processing by the IRS. The present IRS failure to pay (FTP) penalty would be replaced with a cost of collection fee. Since the Service incurs expenses in collecting taxes not covered by the FTP penalty, the new charge would more accurately reflect and recoup the true costs of tax collection operations. Similarly, the administration is seeking to recover all the costs incurred by the Customs Service in conducting border processing activities.			
Government-sponsored Enterprises.....	45	234	473
The budget supports the view that government-sponsored agencies enjoy an implicit subsidy because of their unique relationship to the Federal Government. The budget proposes to phase in a fee on these agencies securities issues to recapture these subsidies, thereby equalizing credit opportunities with other sectors of the economy.			
Nuclear Regulatory Commission (NRC) User Fees.....	153	153	153
The budget proposes that the NRC impose a user fee on operating nuclear power plants, to partially recover NRC's costs of regulating these plants.			

D. Major Program Eliminations and Reductions

MAJOR PROGRAM ELIMINATIONS

PRESIDENT'S 1987 BUDGET

(In millions of dollars)

Program	FY 1986		Fiscal Year 1987 Current Policy		Fiscal Year 1987 President's Budget		Percentage Change	
	BA	O	BA	O	BA	O	BA	O
Entitlements:								
Peacetime Military Education Program	-126	-385	-36	-220	-76	-66	-111	+70
General Revenue Sharing.....	4,005	4,412	4,567	4,152	...	..	-100	-100
Non-Defense Discretionary:								
Export-Import Bank Direct Loans....	351	-156	161	-1,117	...	-955	-100	+15
Overseas Private Investment Corporation.....	...	-100	...	-105	...	-112	...	-7
DOE Low-Income Weatherization..	182	188	189	184	0	NA	-100	NA
Other DOE conservation grant programs..	257	333	268	NA	5	NA	-98	NA
Strategic Petroleum Reserve	403	516	198	555	6	240	-97	-57
REA insured loan level.....	(947)		(986)		(435)		-54	NA
REA guaranteed loan level.....	(975)		(1,015)		(225)		-77	NA
EPA Construction Grants (4-yr. phase-out).....	2,374	2,812	2,505	2,769	1,800	2,395	-28.1	-13.5
Soil Conservation Service small watershed programs	243	274	252	275	84	204	-66.7	-25.8
Agricultural conservation programs.....	235	262	238	256	...	167	-100	-34.8
Intermediate Export Credit Guarantees (loan limit)....	(...)		(500)		(...)		(-100)	
Section 202 Elderly and Handicapped housing.....	584	529	610	632	...	385	-100	-39.1
Rural Housing New Direct Loans	(1,336)		(NA)		(...)		(100)	
Postal Service Foregone Revenue	716	716	741	741	40	40	-94.6	-94.6
SBA.....	868	983	1,204	1,130	95	141	-92.1	-87.5
Amtrak.....	562	675	613	657	...	48	-100	-93

(In millions of dollars)

Program	FY 1986 BA	FY 1986 O	Fiscal Year 1987 Current Policy BA	Current Policy O	President's Budget BA	President's Budget O	Percentage Change BA	Percentage Change O
Mass Transit Interstate Transfer grants*	191	361	219	328	...	333	-100	+1
Mass Transit Washington Metro	217	159	226	235	...	187	-100	-20
Mass transit Section 3 grants	1,053	797	1,096	1,014	...	793	-100	-22
Urban Development Action Grants...	316	499	332	450	...	413	-100	-8
Community Development Section 108 Loan Guarantees. (program level)	111	46	126	46	...	...	-100	-100
Section 312 Rehabilitation Loan Fund.....	0	-2	0	-1	...	-39	-100	-100
Rental Development Grants.....	72	79	75	138	...	135	-100	-2
Rental Rehabilitation Grants.....	72	96	75	163	...	105	-100	-36
Appalachian Regional Commission.....	115	166	120	135	...	147	-100	+9
Rural Water and Waste Disposal Grants	109	183	115	147	...	162	-100	+10
Rural Development Insurance Fund Loan Program Levels:								
Water and waste disposal.....	(325)		(339)		(...)		(-100)	
Community facilities	(96)		(100)		(...)		(-100)	
Industrial Development	(96)		(100)		(...)		(-100)	
Economic Development Administration (non-salaries program)	176	251	185	242	...	183	-100	-24
Small Business Administration: Disaster Loan Fund-Loan Program Levels.....	(574)		(842)		(...)		(-100)	
Rural Telephone Bank Stock Purchase	29	29	30	30	...	...	-100	-100
Immigrant Education	30	29	32	31	...	15	-100	-52
Impact Aid, Part B	124	125	131	129	...	25	-100	-81
Libraries.....	122	134	128	129	...	75	-100	-42
Supplemental Education Opportunity Grants	73	70	77	74	...	38	-100	-49
Work Incentive (WIN)	211	217	222	223	...	41	-100	-82
Community Services Block Grant.....	354	357	374	368	4	62	-99	-83

(In millions of dollars)

Program	FY 1986		Fiscal Year 1987					
			Current Policy		President's Budget		Percentage Change	
	BA	O	BA	O	BA	O	BA	O
Federal funds for Food Safety and Inspection Service (impose user fees)	347	346	353	355	...	-1	-100	-99
Health Professions Education and Training.....	217	223	229	216	3	87	-98.7	-59.7
Indian Health Facilities.....	46	59	48	48	...	37	-100	-22.9
Legal Services Corporation.....	292	301	309	307	...	38	-100	-88
Juvenile Justice Grants.....	67	74	71	70	...	65	-100	-13

*Funding for this program could be eligible under Federal aid highway funding according to the President's 1987 budget.

PRESIDENT'S 1987 BUDGET

MAJOR PROGRAM REDUCTIONS

(In millions of dollars)

Program	FY 1986 BA	FY 1986 O	Fiscal Year 1987 Current Policy BA	Fiscal Year 1987 Current Policy O	Fiscal Year 1987 President's Budget BA	Fiscal Year 1987 President's Budget O	Percentage Change BA	Percentage Change O
Entitlements:								
Guaranteed Student Loans.....	3,313	3,375	3,325	3,289	2,330	2,546	-30	-23
Medicaid.....	24,440	24,440	26,434	26,434	24,708	24,708	-6.5	-6.5
Federal Employees Health Benefits.	1,537	1,373	1,766	1,737	1,147	683	-35.0	-60.7
Medicare.....	86,650	68,650	82,950	76,850	82,250	70,250	-0.8	-8.6
Child Nutrition..	4,114	3,914	4,007	4,168	3,458	3,500	-14	-16
Civil Service Retirement.....	41,839	23,926	43,408	25,178	45,419	24,743	-5	-2
Military Retirement	31,270	17,599	33,856	18,342	33,702	18,516	0	+1
Food Stamps.....	12,852	12,629	13,063	13,056	12,657	12,328	-3	-6
AFDC.....	9,101	9,101	9,492	9,492	8,203	8,203	-14	-14
Crime Victims Fund	100	30	100	60	100	46	...	-23
Non-Defense Discretionary:								
Solar energy R&D.	145	NA	151	NA	73	NA	-50	NA
Energy conservation R&D.....	171	NA	178	NA	71	NA	-58	NA
Fossil energy R&D	343	NA	357	NA	83	NA	-76	NA
Recreation resources.....	1,464	1,461	1,521	1,508	1,147	1,365	-24.6	-9.5
(Land acquisition)	(189)	(242)	(196)	(241)	(33)	(210)	(-83.2)	(-12.9)
USDA Extension Service.....	328	331	345	341	140	179	-59	-48
Short-term Export Credit Guarantees (loan limit)....	(5,264)		(5,000)		(3,000)		(-40)	
Federal Crop Insurance.....	338	557	358	550	240	236	-33	-57
Highway*.....	14,684	13,700	15,299	13,300	12,770	13,184	-17	-1
Mass Transit*....	3,565	3,668	3,729	3,957	1,220	3,300	-67	-17
FAA facilities and equipment.....	950	699	987	873	825	832	-16	-5
FAA R&D.....	182	231	209	207	135	178	-35	-14

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(In millions of dollars)

Program	FY 1986		Fiscal Year 1987					
			Current Policy		President's Budget		Percentage Change	
	BA	O	BA	O	BA	O	BA	O
Coast Guard acq., const. & imp....	208	448	218	428	77	352	-65	-18
Community Development Block Grants (program level)..	2,990	3,559	3,135	3,313	2,625	3,099	-16	-6
Tennessee Valley Authority.....	100	139	104	101	58	108	-44	+7
Vocational Adult Education.....	907	924	960	915	512	820	-47	-10
Student Financial Assistance.....	4,677	4,761	4,945	4,732	3,813	4,264	-23	-10
Higher Education Programs.....	451	447	476	472	262	301	-45	-36
Arts and Humanities	294	321	305	281	271	293	-11	+4
Job Training.....	3,337	3,687	3,527	3,344	2,910	3,133	-17	-7
Health research..	5,533	5,537	5,820	5,582	5,360	5,435	-7.9	-2.6
Indian Health Services.....	808	748	833	832	725	726	-12.9	-12.7
Subsidized Housing	8,535	10,416	9,769	10,866	...	9,177	-100	-16
Veterans' Medical Care.....	9,130	9,161	9,399	9,364	9,086	8,963	-3.3	-4.3
Veterans' Medical Facility Construction....	638	544	670	574	451	713	-33	+24
Payments to States and counties from Forest Receipts..	218	218	252	252	85	85	-66	-66
Payments to States from Receipts under the Mineral Leasing Act.....	532	532	607	607	551	551	-9	-9
Payments to States and counties from Federal management activities.....	76	74	82	80	59	57	-28	-29

*The President has proposed a block grant containing some locally-oriented highway programs and most mass transit programs starting in 1987. This table assumes States will maintain these highway programs in the block grant at 1986 funding levels.

VI. ANALYSES OF SELECTED BUDGET ISSUES AND POPULATION GROUPS

A. Federal Aid to State and Local Governments

resident Reagan's 1987 Budget

The 1987 budget proposes Federal grants to State and local overnments in fiscal year 1987 of $89.1 billion in budget authority and 99.1 billion in outlays. For fiscal year 1986, the budget includes 105.2 billion in budget authority and $108.8 billion in outlays.

The 1987 request represents a decrease of $27.0 billion in budget uthority and $11.9 billion in outlays from the 1987 preliminary CBO aseline. The request for fiscal year 1986 represents a decrease of 4.1 billion in budget authority and an increase of $0.6 billion in utlays compared to the preliminary CBO baseline for 1986.

In addition, the fiscal year 1987 proposal represents a decrease of 16.7 billion in budget authority and an increase of $4.3 billion in utlays when compared to fiscal year 1981. In real terms, the budget uthority reduction is a 35 percent decrease compared to the 1981 level. ollowing is a table which summarizes Federal grant aid since 1980:

Historical Summary of Aid to State and Local Governments

(In billions of dollars)

Fiscal Year	Budget Authority	Outlays	Outlays as Percent of Total Budget Outlays	Outlays as Percent of GNP
980 Actual	105.0	91.5	15.5	3.4
981 Actual	105.8	94.8	14.0	3.2
982 Actual	91.9	88.2	11.8	2.8
983 Actual	99.6	92.5	11.4	2.8
984 Actual	111.9	97.6	11.5	2.6
985 Actual	114.0	105.9	11.2	2.6
986 Preliminary CBO Baseline	109.3	108.2	11.0	2.7
986 Administration's Estimate	105.2	108.8	11.1	2.6
987 Preliminary CBO Baseline	116.1	111.0	10.9	2.5
987 Administration	89.1	99.1	10.0	2.2
988 Administration	NA	99.2	9.7	2.0
989 Administration	NA	99.6	9.4	1.9
990 Administration	NA	101.6	9.3	1.8
991 Administration	NA	102.4	9.1	1.7

Impact of 1987 Budget Proposals

A. Historical Perspective

The proposed fiscal year 1987 budget continues the trend of previous administration budget submissions of significantly reducing the percentages of the Federal budget and the Gross National Product that are devoted to assistance to States and localities. These reductions are reflected in Table 1.

In the aggregate, the actual level of Federal assistance to states and localities has declined from 15.5 percent of the total budget and 3.4 percent of GNP in 1980, to 11.2 percent of the total budget and 2.7 percent of GNP in 1985. This reduction in Federal assistance to States and localities represents a significant reordering of Federal budget priorities.

The 1987 budget proposal would reduce Federal assistance to state and local governments to 10 percent of total budget outlays; this amount would decline to 9.1 percent by 1991. The levels in the budget proposals are roughly equal to the funding percentage during the mid-1960's.

An additional measure of the Federal funding shifts in aid to State and local governments is the percentage that Federal assistance represents in terms of State-local receipts from own sources. Since 1980, the percentage that Federal assistance represents has declined from 31.7 percent to 23.7 percent in 1984. The Advisory Commission on Intergovernmental Relations projects a decline to 21.4 percent by the end of 1986. The projected 1986 level would be roughly equivalent to the level that existed before 1970.

B. Brief Overview of the Budget Proposals for Federalism

The budget proposes significant program changes, program terminations and overall funding reductions in aid to State and local governments. These proposals are based on the administration's efforts "to restrain Federal spending and to reduce Federal involvement in activities that are primarily State and local responsibilities."

The budget proposals include program and management "reforms", reductions, and terminations.

- The major changes include: a new transportation block grant proposal for local highway and transit facilities which would reduce mass transit assistance by over 65 percent; expansion of the primary health care block grant to include more programs with no additional funds; consolidation of seven environmental programs into a pollution control block grant with a broader set of program goals but with diminished resources; and changes in the Federal payment for state administrative expenses associated with various social service programs. These administrative reforms would likely increase costs to States and could provide an incentive to reduce benefits.

- Major program terminations include the general revenue sharing program (including a 1986 rescission), the urban development action grant and several other urban and rural economic development assistance programs, and termination of the work incentive program, the community services block grant and EPA water and sewer grants.

- In addition, large reductions in the Federal highway program, the community development block grant programs and funding reductions in the medicaid program are proposed.

C. Major Assistance Programs

In fiscal year 1987, 20 Federal grant programs will account for 84 percent of total Federal grant outlays. Table 2 compares the President's budget proposals for these programs to the fiscal year 1987 preliminary CBO baseline. Large program reductions would occur in subsidized housing, General Revenue Sharing, and in the Medicaid, highways and mass transit programs. Small increases would occur in low-income energy assistance and the unemployment trust fund.

TABLE 1. Major State and Local Assistance Programs

President's Budget Compared to the Preliminary CBO Baseline

(In millions of dollars)

Program	FY 1987 Preliminary CBO Baseline		President's Budget Fiscal Year 1987		Increase/ Decrease from the Preliminary CBO Baseline	
	BA	O	BA	O	BA	O
caid.....	26,434	26,434	24,708	24,708	-1,726	-1,726
way Trust Fund.....	15,161	13,180	12,625	13,034	-2,536	-146
idized Housing.....	9,768	5,867	...	3,858	-9,768	-2,009
istance Payments.....	9,454	9,454	8,171	8,171	-1,283	-1,283
eral Revenue Sharing.....	4,566	4,152	...	...	-4,566	-4,152
d Nutrition.....	3,806	3,959	3,424	3,462	-382	-497
pensatory Education.....	3,732	3,556	3,682	3,529	-50	-27
an Transit*.....	3,236	2,824	1,220	3,328	-2,016	+504
.....	3,134	3,313	2,125	3,099	-1,009	-214
ining & Employment Services	2,680	2,742	2,477	2,661	-203	-81
al Services Block Grants..	2,700	2,693	2,700	2,693	...	...
Construction Grants.....	2,504	2,768	1,800	2,342	-704	-426
-Income Energy.....	1,917	1,926	2,098	2,098	+181	+172
an Development Services....	1,956	1,897	1,866	1,848	-90	-49
.....	1,607	1,603	1,615	1,611	+8	+8
mployment Trust Fund.....	1,507	1,693	1,742	1,742	+235	+49
ration of Low Income using.....	1,341	1,381	1,172	1,297	-169	-84
abilitation Services and ndicapped Research.....	1,087	1,079	1,137	1,108	+50	+29
cation for Handicapped.....	1,284	1,185	1,177	1,135	-107	-50
port Trust Fund.....	1,017	852	1,017	828	...	-24
Subtotal.....	98,891	92,558	74,756	82,552	-24,135	-10,006
Other.....	17,230	18,472	-14,390	16,542	-2,840	-1,930
AL.....	116,121	111,030	89,146	99,094	-26,975	-11,936

w urban transportation block grant.

Current Fiscal Condition of State and Local Governments

State Fiscal Conditions

One normative measure of State fiscal health has been a budget balance of at least 5 percent of overall expenditures. Based on the latest available data from the "Fiscal Survey of the States 1985" conducted by the National Governors' Association and the National Association of State Budget Officers, year end balances will be $4.2 billion or 2.1 percent for 1986. However, almost one-half of the aggregate ending balances occur in only four States. In addition, the survey projected that fiscal 1986 general fund budgets would grow 6.7 percent and revenue growth is projected to increase 5.7 percent. When the survey was published in July of 1985, 27 States had budget stabilization ("rainy day") funds and their cumulative balance was projected at $2.1 billion or about 1 percent of total expenditures.

The survey also reported that 23 states raised taxes in 1985, while 15 states decreased them. The net total tax change was a decrease of $0.7 billion or one-half percent of state revenues. An additional issue that the survey highlighted is the wide variance in economic and fiscal conditions among states.

A second measure that is often used to guage the fiscal condition of States and local governments is the National Income Products Accounts (NIPA). Accordingly, the current NIPA projections show a 1985 surplus of $5.4 billion in the operating accounts. In the past there has been confusion in citing the NIPA accounts and some reports have discussed surpluses of $50 billion in the State-local sector. These estimates include the surpluses in social insurance funds which are projected to be $52.9 billion in 1985, but which are not available to fund operating programs of States or localities.

A third indicator of the general economic health of the State and local sector is the unemployment data provided by the U.S. Bureau of Labor Statistics. The latest State and metropolitan data was reported in January and is based on the month of November. At that time, 21 States were reporting decreases in unemployment compared to November 1984, with seven having declines of one percent or more. However, unemployment rates increased one point or more over the year in 13 States, with increases in excess of two percentage points in three states. Sixteen States reported unemployment rates below six percent, with New Hampshire the lowest at 2.7 percent and Massachusetts second with 3.6 percent. Four states reported double digit unemployment, with West Virginia the highest at 13.6 percent. This data supports the NGA survey data reporting the wide variance of fiscal conditions among states.

Current Fiscal Conditions of Cities and other Localities

The Joint Economic Committee (JEC) published a study in May of 1985, "Trends in the Fiscal Conditions of Cities: 1983-1985. This study detailed the following:

- Cities after several years of shrinkage are experiencing a recovery in revenues and spending levels.

- Cities, on average, reported small current surpluses..nonetheless, a substantial minority of cities (47 percent) continue to run current spending deficits.

- Cities should repeat their performance of the past two years, and on an average, end up the year with modest current surpluses.

- Federal aid continues to decline as a source of revenues, with the largest reductions in the large and largest cities.

- As of 1985, Federal aid is projected to decline to 5.6 percent of the average city operating budget in contrast to approximately 11 percent in the 1970's.

- State aid continues to grow in importance, having increased by seven percent between 1983 and 1984, and projected to grow by 10 percent the following year.

A second relevant study was conducted by the National League of Cities hich surveyed 478 elected officials in 371 different cities. The study ublished January 8, 1986 reports the following:

- Thirty-nine percent responded that loss of Federal aid will create the greatest demands on their budgets.

- Forty-nine percent believe that they can meet current service levels without a tax increasee, 38 percent foresee a tax increase.

- Sixty percent responded that local economic and fiscal conditions did not improve in 1985. However, local mortgage conditions and interest rates on city borrowing did improve.

- Slightly more than half reported that the demand for emergency services such as shelter, food and medical care remained about the same while 46 percent said demand increased.

- The overall consensus was toward a continued national economic recovery and city recovery but more often than not without great strength and impact.

B. Rural America

Rural America continues to experience acute financial distress. Net real farm income recovered somewhat in calendar year 1984 to $15.5 billion (in constant 1972 dollars), up from $7.0 billion in calendar year 1983. The preliminary USDA tabulation of 1985 real net farm income is $12.0 billion and the USDA projection for 1986 is a further decline to $9 to $11 billion. These amounts are well below the record year of 1973 when net real farm income was $32.6 billion. This depressed farm income has resulted in sharp increases in farm loan delinquencies and bankruptcies.

This financial distress has occurred despite record Federal payments to farmers. Net Federal outlays for price support loans and direct payments expanded from $4.0 billion in fiscal year 1981 to a record $18.8 billion in fiscal year 1983. Outlays in 1984 dropped to $7.3 billion because the payment-in-kind (PIK) program put in place in 1983 by the Reagan administration induced farmers to reduce production and led to a significant decrease in the amount of crops placed under CCC loans in 1984. New spending for price support programs increased to $17.7 billion in 1985 after completion of the PIK program. In addition, off-farm income earned by farmers has continued to grow. Undoubtedly, without increased Federal payments and loans and growing off-farm income, the financial distress among farmers would be even more severe than it is.

The causes of this financial distress are complex and overlapping. A major cause is the decline in farm exports. American agriculture produces far more food and fiber than is needed for domestic consumption. Exports are necessary to sell an estimated 40 percent of American crops. After growing from $7.7 billion in 1971 up to $43.3 billion in 1981, U.S. farm exports declined to $31.2 billion in 1985 (preliminary). USDA projects that exports will continue to decline in 1986 down to $29.0 billion. This decline in export volume stems from the current high value of the dollar relative to other currencies, which makes American commodities more expensive; from the world-wide recession of 1982 and 1983; and from the expansion of the productive capacity of foreign agriculture. This expansion of foreign capacity has been encouraged by the effective floor placed under world commodity prices by the U.S. Federal price support system.

A second cause of financial distress is the high real interest rates experienced in recent years. This is especially a problem for farmers which expanded rapidly during the late 1970's and early 1980's. The USDA has reported that, at the beginning of 1985, 9.6 percent of all farm operators had debt/asset ratios of more than 70 percent. The USDA has also reported that the number of farmers with debt/asset ratios greater than 40 percent has increased to 20.7 percent. Many of these farmers are financially vulnerable because of the higher real interest rates which have occurred in 1983 through 1985. Finally, the declining value of farm assets is pointed to as a cause of financial distress. The value of farm real estate has declined from $847 billion at the end of 1980 to $694 billion at the end of 1984. This deflation in the value of farm collateral has directly reduced how much farmers may borrow.

In response to this financial distress, two major pieces of legislation affecting rural America were enacted in 1985. The Farm Credit Act Amendments

of 1985 authorized Federal assistance for the Farm Credit System (FCS), which is experiencing record numbers of problem loans as a result of the financial distress in agriculture. The law requires that the internal resources of the FCS be used up before Federal assistance can be extended. The second major law enacted was the Food Security Act of 1985 (the 1985 farm bill). This law provides a significant shift in the focus of Federal agriculture policy. The major features of this 1985 farm bill include:

- A gradual decline in crop loan rates to help make American commodities more competitive on world markets.
- Freezing target prices in 1986 and 1987 to help protect farm income, with gradual declines starting in 1988.
- A requirement for advance deficiency payments in 1986 and discretionary authority for advance payments in 1987 and future years to assist in crop production financing.
- Major commodity export assistance to combat unfair foreign trade practices and to ease the transition to a more competitive world trade for agricultural goods.
- A new conservation reserve program and strengthened sodbuster provisions to protect marginal land from overproduction.
- A dairy diversion program and authority for dairy herd buyouts to help reduce the surplus of milk products.

The preliminary CBO baseline estimates that these commodity program changes will result in $25.0 billion of CCC spending in 1986, but a sharp decline to $14.7 billion in 1987.

President Reagan's 1987 budget proposes a 12 percent decrease in funding for aggregate Federal assistance for rural programs from the preliminary CBO baseline estimate (see the attached table). This reduction appears to be similar to the size of reductions proposed for other non-defense program areas. The major budget proposals for rural programs include:

- Elimination of Farmers Home Administration (FmHA) rural housing loans. These loans are proposed to be replaced by a housing voucher program administered by HUD.
- Termination of Agricultural Stabilization and Conservation Service conservation programs.
- Termination of FmHA rural water and waste disposal grants.
- Elimination of the Appalachian Regional Commission and the Economic Development Administration.
- A 59 percent reduction in Federal funding for the Extension Service from the preliminary CBO baseline estimate of $345 million down to $140 million.

- Legislative proposals to eliminate intermediate term CCC commodity export credit guarantees and to reduce short term export credit guarantees from $5.0 to $3.0 billion in 1987.

- A phase-out by 1990 of all REA rural electric and telephone loans, including a $1.0 billion reduction for new loans in 1987 from the 1986 level of $3.21 billion down to $3.25 billion in 1987.

RURAL PROGRAM FUNDING

(In millions of dollars)

Program	1986 Preliminary CBO Baseline		FY 1987 Preliminary CBO Baseline		FY 1987 President's Budget	
	BA	O	BA	O	BA	O
Function 270:						
Rural electrification and telephone loans.....	2,375	1,521	2,081	1,821	1,809	1,310
Function 300:						
Soil Conservation Service	636	657	651	676	457	597
ASCS conservation programs	201	226	208	222	...	54
Bureau of Reclamation.....	688	835	696	717	934	986
Function 350:						
Commodity price support programs (CCC).....	24,986	24,986	14,715	14,710	15,516	16,186
Farm operation and ownership loans (ACIF)...	3,393	3,319	2,816	2,581	2,301	1,497
Federal Crop Insurance....	338	557	358	550	240	236
Agricultural research.....	757	754	784	760	759	758
Extension Service.....	328	331	345	341	140	179
Other agricultural services and operations..	791	839	817	844	627	685
Function 370:						
Rural housing loans.....	3,465	3,697	3,517	3,546	2,865	1,666
Function 450:						
Community development block grants (CDBG) (30 percent rural share under current law).....	897	1,068	941	994	744	1,085
FmHA rural development loans	1,010	1,084	1,019	1,182	740	1,001
Rural water and waste disposal grants.....	109	183	115	147	...	162
Economic Development Administration (50 percent rural share).....	101	138	105	134	...	103
Appalachian Regional Commission.....	115	166	120	135	...	124
TVA regional development programs.....	100	139	104	101	58	108
Farmers Home Administration salaries and expenses....	357	366	362	362	383	381

RURAL PROGRAM FUNDING

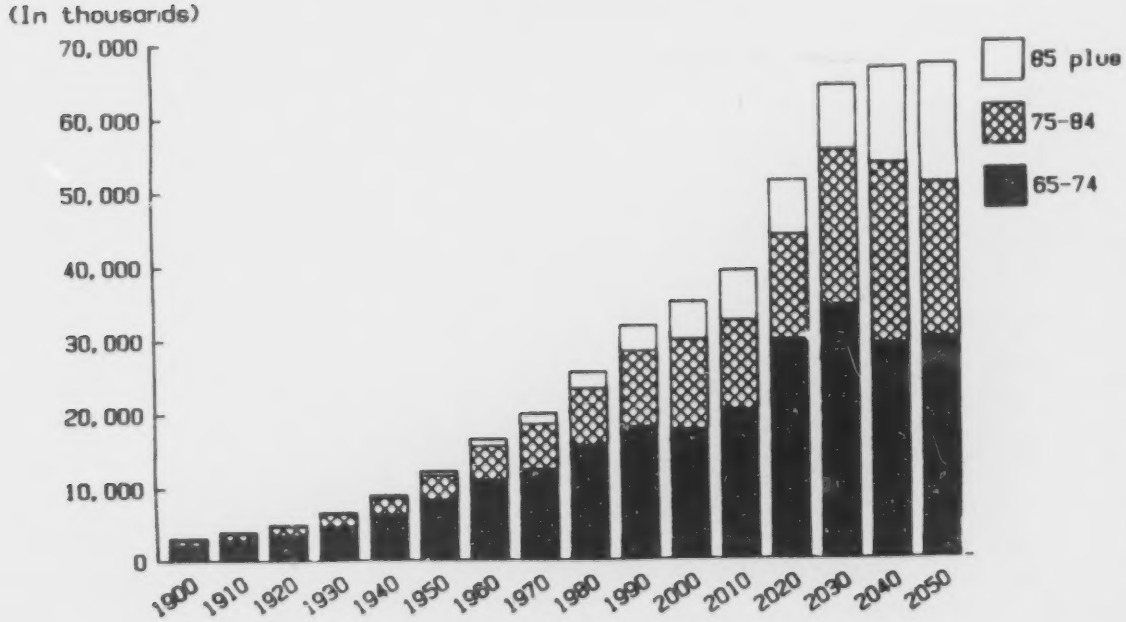
(In millions of dollars)

Program	1986 Current Estimate		FY 1987 Preliminary CBO Baseline		FY 1987 President's Budget	
	BA	O	BA	O	BA	O
Function 550:						
Proposed meat and poultry inspection fees.....	...	...	...	...	-366	-366
Function 600:						
FmHA rural housing assistance programs.....	49	38	50	60	...	45
Function 800:						
Proposed new user fee for Farm Credit System.....	...	...	...	...	-9	-9
Function 850:						
General revenue sharing (25 percent rural share)	1,001	1,103	1,142	1,038	...	...
BLM payments to States from mineral lease receipts..	532	532	607	607	551	551
Forest Service payments to States and counties.....	218	218	252	252	85	85
Payments in Lieu of Taxes	100	100	104	104	105	105
TOTAL.....	42,498	42,857	31,909	31,884	27,939	27,529
Percentage reduction from preliminary CBO baseline...					-12.4	-13.7

C. Older Americans

Older Americans (persons 65 years of age or older) now are about 11.5 percent of the U.S. population. However, both the number of older Americans and the average age is increasing rapidly. In fact, persons over 65 years of age are increasing faster than any other segment of the American population. By the year 2020, Older Americans will constitute as large a segment of the total U.S. population as they do today for the State of Florida, about 17 percent. In addition, by the year 2020, persons over 75 years of age will constitute 12 percent of the U.S. population, a figure that is slightly more than the proportion of all elderly in the U.S. population today. The increase in the U.S. elderly population is shown below:

ACTUAL AND PROJECTED POPULATION
AGE 65 YEARS AND OLDER
1900 - 2050



The increasing number of elderly persons has substantial implications for Federal budget planning because the elderly receive significant proportions of their income through Federal assistance programs, the most significant of which are social security and medicare. Over 94 percent of the elderly receive social security. For 60 percent of the elderly, social security represents at least half of their total income. The following table indicates the percentage of elderly family income which is derived from social security.

PROPORTION OF ELDERLY FAMILY
INCOME DERIVED FROM SOCIAL SECURITY

Proportion of Family Income	Proportion of Elderly Families
None	6.3 %
1-24.9%	9.8%
25-49.9%	23.6%
50-79.9%	35.6%
80-89.9%	6.4%
90% or more	18.3%

When supplemental security income (SSI) is added to the above figures, over 25 percent of the elderly are dependent upon the Federal Government for 90 percent or more of their income.

Medicare assists the elderly by paying 48.8 percent of their medical bills. Medicaid pays another 12.8 percent for the low-income elderly. The table below indicates the degree to which the elderly are dependent upon these two and other public funding sources as opposed to private sources to meet their health care needs:

PROPORTION OF ELDERLY HEALTH
CARE PAID BY VARIOUS SOURCES

Source	% of Health Care Paid
Private	32.8
Consumer	32.4
Out-of-pocket	25.2
Insurance	7.2
Other Private	0.4
Government	67.2
Medicare	48.8
Medicaid	12.8
Other Government	5.6

In addition to medicare and social security, the 1987 budget proposes changes in a number of other programs which are of special interest to the elderly:

Social Security: No reductions proposed; the budget requests full funding for the old-age, survivors' and disability programs. A cost-of-living-adjustment (COLA) of 3.7 percent would be awarded to the 38 million retired and disabled beneficiaries and their dependents in January 1987.

Medicare: The budget proposes reductions in 1987 of $4.70 billion. The budget would reduce spending by $4.0 and increase beneficiary premiums by $0.70 billion in 1987. By 1991, beneficiary premiums would increase by 30 percent compared to current law. In addition, the Part B deductible will increase from $75 to $100 in 1987 and a new copayment for home health services would be required. These increases would have to be paid by medicare beneficiaries. In addition, reductions are proposed for hospital, physician and other provider payments. The reductions would total $23 billion over 1987-1989.

Older Americans Act: The budget proposes an increase in 1986 of 18 million. The budget proposes a fiscal year 1986 funding level of $689 million. All programs except research, training and discretionary projects would be restored to the 1986 pre-Gramm-Rudman funding level. Such local agency programs would be held at the 1985 appropriations level.

Elderly and Handicapped Housing: The budget proposes reductions in 1987 of $610 million. The budget proposes to terminate the Section 202 elderly and handicapped housing program. This program provides direct loans to nonprofit organizatons which construct housing for lower income elderly and handicapped. This reduction is one of a number of reductions proposed for subsidized housing, rental housing and other housing programs. Over 1987-89, the reductions would total $1.9 billion.

Medicaid: The budget proposes reductions in 1987 of $1.15 billion. Of the 22 million medicaid recipients, approximately 14 percent are aged, yet nearly 40 percent of medicaid payments go for services for the aged. Because of age and disability, this group requires more acute and long-term care, which accounts for the disproportionate share of medicaid payments. Therefore, any reductions in Federal medicaid funding could have a particularly adverse impact on the poor elderly. The 1987 budget proposals would reduce medicaid costs by $7.0 billion over 1987-1989. In future years only growth in medical care inflation would be allowed.

General Retirement and Disability Programs: The budget proposes reductions in 1987 of $0.25 billion. The budget provides outlays of $5.45 billion for general retirement and disability programs other than social security and Federal employee retirement. The budget assumes enactment of a freeze on COLAs in fiscal year 1987 for the private pension components of the railroad retirement program and industry financing of 25 percent of the cost of

the dual benefit that goes to certain railroad retirees who are also eligible for social security. The budget also assumes the resubmittal of proposals to increase the premiums paid by employers to the Pension Benefit Guaranty Corporation and to increase the coal tonnage tax which finances a portion of the benefits in the black lung program.

Civil Service and Military Retirement: The budget proposes reductions in 1987 of $1.15 billion. The budget provides outlays of $42.45 billion for Federal employee retirement and disability programs. The budget proposes to continue the freeze on COLAs for military and civilian retirees which was imposed this year by the sequestration process mandated by the Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177). In addition, the reductions assume enactment of a number of structural changes to the Federal civilian program similar to ones transmitted by the administration in previous budgets, including: an increase in the retirement age for retirees, basing annuity amounts on a longer period of service, reducing COLA's after fiscal year 1987 by two percentage points below the increase in the Consumer Price Index (CPI) and terminating student benefits. Finally, the budget proposes to increase the contribution for retirement which Federal civilian workers pay.

The budget proposes one structural change to the military retirement system. This change would be to base the initial retirement benefit for service members who entered military service after September 1980 on the highest three years of basic pay rather than their final basic pay.

D. Programs Primarily Affecting Low-Income and Other Disadvantaged Individuals

The 1987 budget proposes $87.65 billion for programs affecting low-income and other individuals at a disadvantage within the society. This represents a reduction of $17.20 billion (16 percent) from the preliminary 1987 CBO baseline and $12.0 billion (12 percent) from the 1986 levels. The programs in this analysis were identified as low-income and high priority programs in the First Concurrent Resolution on the Budget, Fiscal Year 1986. The budget proposes to continue the decline in spending for these programs.

The administration is proposing another round of reductions in entitlement spending especially in the Medicaid, Food Stamps, AFDC and child nutrition programs. These proposed reductions represent a decrease of two percent from the 1986 funding level and six percent from the preliminary 1987 CBO baseline.

The budget proposes that low-income discretionary programs be cut $13.05 (37 percent) from the preliminary fiscal year 1987 CBO baseline. This would be a 33 percent ($10.75 billion) cut from the fiscal year 1986 funding levels. Included are proposals to eliminate five programs: WIN, community services block grants, low-income weatherization, Legal Services and juvenile Justice assistance. The single largest reduction in discretionary programs occurs in subsidized housing -- a reduction of $9.75 billion, or 77 percent, from the preliminary 1987 CBO baseline and a reduction of $8.40 billion, or 74 percent, from the 1986 funding level. This reduction is primarily due to the proposal to end new building or rehabilitation commitments for subsidized and public housing, and in lieu thereof, establish a voucher system which would be available only if a recipient found adequate private housing.

The budget includes proposals to increase funding over the 1986 level for seven low-income discretionary programs and provide funding near or at the fiscal year 1986 pre-Gramm-Rudman appropriation levels. Included in this group are: compensatory and Indian education, older workers employment, child welfare, Head Start, energy assistance, and WIC.

The following table compares the President's proposed funding levels with the 1987 CBO preliminary baseline.

FUNDING FOR LOW-INCOME PROGRAMS

(Budget authority in millions of dollars)

	1986 Current Level	1987 Preliminary CBO Baseline	1987 Reagan Request
Entitlement Programs			
Medicaid	24,440	26,434	24,708
Food Stamps	12,582	13,063	12,344
AFDC	9,101	9,492	8,207
SSI	10,150	10,405	10,535
Veterans' Pensions	3,808	3,768	3,824
Child Nutrition	4,114	4,007	3,459
Earned Income Tax Credit	1,283	1,232	1,228
Vocational Rehabilitation State Grant	1,145	1,182	1,100
Subtotal, Entitlements	66,623	69,583	65,405

(Budget authority in millions of dollars)

Discretionary Progams	1986 Current Level	1987 Preliminary CBO Baseline	1987 Reagan Request
Compensatory Education.....	3,537	3,740	3,688
Indian Education.....	321	340	328
Handicapped Education.....	1,350	1,428	1,303
Student Financial Assistance.....	4,677	4,945	3,813
TRIO and Historically Black Colleges	304	320	223
Job Training.....	3,337	3,527	2,910
Work Incentive (WIN).....	211	222	...
Older Americans Employment.....	312	324	326
Vocational Rehabiliation 1/.....	164	174	125
Child Welfare Services.....	198	209	200
Head Start.....	1,040	1,095	1,075
Community Services Block Grant.....	312	324	4
Low-Income Weatherization.....	182	189	...
Low-Income Energy Assistance.....	2,010	1,919	2,100
WIC and CSFP.....	1,597	1,650	1,617
Special Health Programs 2/.....	1,712	1,784	1,556
Legal Services.....	292	309	...
Juvenile Justice Assistance.....	67	71	...
Subsidized Housing.....	11,390	12,719	2,986
Subtotal, Discretionary	33,013	35,289	22,254
TOTAL	99,636	104,872	87,659

Notes

1/ The basic state grant portion of this program is an entitlement and is listed in the entitlement section.

2/ Includes community health centers, family planning, migrant and Indian health, immunizations, vaccine supplies, and AIDS research and projects. The President's 1987 budget again proposes the consolidation of community health centers, family planning, migrant health and black lung clinics into a primary care block grant. Since discrete program amounts are not available, a pro-rata share based on 1986 was derived for this table.

E. Minorities

The 1987 "Budget Message" begins, "The economic expansion we are now enjoying is one of the most vigorous in 35 years. Family income is at an all-time high; production and productivity are increasing; employment gains have been extraordinary...." In contrast to the picture described in this message, many minority Americans, especially blacks, have been worse off under the policies of this administration than they were in the previous four years. Several factors may be used to measure the relative well-being of minority citizens compared to the larger population. Among these are levels of unemployment, family income, and poverty rates relative to whites. The statistics on these indices show that blacks actually have been worse off under the Reagan administration than they were during the four years immediately before the current administration, for example:

Unemployment

1978 - 81	Black unemployment exceeded white by 8 percentage points.
1982 - 85	Black unemployment exceeded white by 9.9 percentage points.

Family Income

1978 - 81	Black families earned 58 cents for every dollar of white family income.
1982 - 85	Black families earned 56 cents for every dollar of white family income.

Families in Poverty*

1978 - 81	The proportion of black families living in poverty was 21.1 percentage points greater than for whites.
1982 - 85	The proportion of black families living in poverty was 22.6 percentage points greater than for whites.

The country experienced one of the worse recessions during 1981 -1982. The current stage of economic prosperity followed that recession. However, for Blacks and Hispanics, available data indicates that they suffered disproportianately during the recession and have not yet regained their pre-recession relative status. In fact, when unemployment levels are considered, Black men and teenagers and Hispanics have higher unemployment levels today than they had prior to 1981 as the following table shows:

*In 1984 the poverty level was defined as an income of $10,609 or less for a family of four.

U.S. UNEMPLOYMENT BY RACE AND AGE

	December 1980	Recession High Point December 1982	December 1985
Employment			
All Civilian Workers	7.2	10.7	6.9
White	6.3	9.6	5.9
Black	15.0	20.9	14.9
Hispanic	10.3	15.7	10.4
Men 20 and Over*			
White	5.3	8.8	5.1
Black	12.0	20.7	13.1
Women 20 and Over*			
White	5.8	8.2	5.4
Black	13.5	16.7	12.6
Teenagers*			
White	17.0	21.6	15.9
Black	40.5	49.1	41.6

*Age data is not available for Hispanics.

The table above indicates that over two-fifths of black teenagers currently are unemployed. Recently, national attention has been focused on the staggering problem of teenage pregnancy among blacks in this country and the debilitating effect of such pregnancies on black family life. The continuing high unemployment level among black men, particularly teenagers, is one aspect of that problem.

There is no indication in the budget that specific action will be taken to address this problem. In fact, programs which might provide training and thereby increase employment opportunities for black youth are substantially reduced in the 1987 proposals, for example:

-- Job Training Partnership Act (JTPA) funding is reduced by $0.45 billion, or 13.4 percent, to a request of $2.90 billion in 1987. The $613 million Job Corps and the $636 million summer youth training programs which are funded under JTPA, would be reduced by 43 percent and 33 percent, respectively.

-- WIN (Work Incentive Program) is proposed for elimination. The budget does not propose any alternative program to WIN, which makes grants to states to assist welfare recipients to become employed.

The 1987 budget also continues to propose reductions in funding for a number of programs which have supported economic development, job training, and education for minorities. Additionally, the budget proposes reductions for those human services programs that have provided the social safety net for unemployed and other low-income persons. The specific reductions are described below:

Program Levels for Federal Programs Assisting Minorities

(In billions of dollars)

	1986 Current Level	1987 Pres. Request
Domestic Discretionary Programs		
Economic Development		
• Small Business Administration-Provides technical and financial assisance to small businesses and assists in the establishment and expansion of minority-owned businesses.	0.85	0.10
• Economic Development Administration-Provides job opportunities, financial and technical assistance in economically distressed areas.	0.20	...
• Urban Development Action Grants-Provides grants to distressed cities and urban counties for economic development projects.	0.30	...
• Community Development Block Grants - Makes grants to local governments and States for economic development projects.	3.00	2.65
Training and Employment		
• Job Training Partnership Act (JTPA) - JTPA provides training to the unemployed and economically disadvantaged. JTPA grants are made to States and localities for this purpose. Part of the administration's budget cutting efforts include a 43 percent reduction in the $613 million Job Corps program and 33 percent reduction in the $636 million summer youth employment program, both of which are a part of JTPA.	3.35	2.90

	1986 Current Level	1987 Pres. Request
Training and Employment		
• Work Incentive (WIN) - WIN makes grants to States to assist individuals on welfare to either become employed or employable.	0.20	...
Education		
• Compensatory Education - Makes grants to local education agencies to assist in the educational development of educationally disadvantaged youths.	3.55	3.70
• Student financial Assistance - Provides grants and/or loans to needy students attending post-secondary institutions.	4.70	3.80
• Health professions grants for disadvantaged students and colleges in financial distress (targeted especially to minorities).	0.05	...
Low-Income Housing Energy Assistance		
• Subsidized Housing - Provides housing assistance to low-income families.	11.40	3.00
• Low-Income Energy assistance--provides assistance to low-income persons to help them meet heating costs. The President's budget proposes a freeze and assumes less carryover balance from 1986 than does the CBO preliminary baseline.	2.00	2.10
Nutrition Assistance		
• WIC - Provides nutrition assistance to low-income pregnant women, nursing mothers and infants.	1.65	1.60

Domestic Entitlement Programs

The President also proposes to reduce some entitlement programs which are of high priority for minorities. The reductions in such programs are below the current service level.

	1987 President's Budget Reductions
Education	
• Guaranteed Student Loans - Makes loans to students attending post-secondary institutions.	-0.85
Low-Income Assistance	
• Medicaid-Provides Federal matching for State-administered health care and services to about 22 million low-income Americans. The 1987 request includes reductions of $1.15 billion below current policy.	-1.15
• Medicare-Finances Health care for 31 million elderly and disabled persons including low-income persons.	-4.70
• Public Assistance (AFDC) - Provides income and child support to children and families.	-0.25
• Child Nutrition Programs - Provides nutrition assistance to children, primarily through schools and other public institutions.	-0.70
• Food stamps - Provides nutrition assistance through vouchers which enable low-income persons to purchase food.	-0.30

F. The Unemployed

After three years of economic recovery, the overall civilian unemployment rate was a little lower than it had been in December 1980, but structural unemployment problems were at least as bad as they had been five years earlier. Only whites have experienced improvement; black and Hispanic unemployment rates were unchanged.

Table 1 compares unemployment measures for various population groups in December 1980 and December 1985:

- Blacks are still 2.5 times as likely as whites to be unemployed, and Hispanics 1.8 times as likely.
- Women who maintain families are still more than twice as likely as married men to be unemployed.
- The number of long-term unemployed has grown slightly as a proportion of total unemployment.
- Unemployment insurance coverage has dwindled, reflecting program changes and exhaustion of benefits by the long-term unemployed.

As another indicator of the growth in long-term unemployment, the average duration of unemployment was 15.4 weeks in December 1985. This is considerably improved from a postwar high of 20.5 weeks reached two years earlier. Yet this average duration was still well above the 1950-80 average of 11.7 weeks.

Table 1

Structural Problems in U.S. Labor Markets

	December 1980	December 1985
Unemployment Rates (percent of labor force):		
All civilian workers	7.2	6.9
White	6.3	5.9
Black	15.0	14.9
Hispanic	10.3	10.4
Ratios to white rate:		
Black	2.4	2.5
Hispanic	1.6	1.8
Men 20 and older:		
White	5.3	5.1
Black	12.0	13.1
Ratio, black/white	2.3	2.6
Women 20 and older:		
White	5.8	5.4
Black	13.5	12.6
Ratio, black/white	2.3	2.3
Teenagers:		
White	17.0	15.9
Black	40.5	41.6
Ratio, black/white	2.4	2.6
Married men	4.2	4.3
Women who maintain families	10.1	9.4
Ratio, women who maintain families to married men	2.4	2.2
Long-term Unemployment (thousands of workers):		
Number unemployed 27 weeks and over	1,150	1,215
Percent of total unemployment	14.9	15.1
Coverage of Unemployment Insurance (thousands of workers, not seasonally adjusted):		
Number of job losers unemployed	4,158	4,063
Number receiving unemployment insurance, all programs	4,013	2,844
Percent of job losers receiving UI	96.5	70.0

Unemployment is unevenly distributed across the U.S., and the unevenness in increasing. Table 2 shows unemployment rates by state for November 1980 and November 1985. (The December report is not yet available.) Whereas unemployment rates ranged from 4.0 percent to 12.5 percent in November 1980, they ranged from 2.7 percent to 13.6 percent in November 1985. (A more precise measure of dispersion, the statistical "standard deviation," is higher in November 1985 than it was in November 1980.) One state had double-digit unemployment in November 1980; there were four such states in November 1985.

Table 2

Unemployment Rates by Sta e
November 1980 and November 1985
(percent of labor force)

State	November 1980	November 1985
Alabama	9.4	7.8
Alaska	9.3	10.2
Arizona	6.4	6.4
Arkansas	8.1	9.4
California	7.1	6.6
Colorado	6.0	6.2
Connecticut	5.6	4.2
Delaware	6.7	4.3
District of Columbia	7.5	8.4
Florida	5.5	5.5
Georgia	6.1	6.1
Hawaii	4.9	5.6
Idaho	6.9	7.6
Illinois	8.1	9.0
Indiana	9.2	7.2
Iowa	5.6	7.4
Kansas	4.3	5.2
Kentucky	7.8	10.0
Louisiana	7.4	11.0
Maine	7.0	4.6
Maryland	6.3	4.5
Massachusetts	4.5	3.6
Michigan	12.5	8.9
Minnesota	5.5	6.4
Mississippi	7.6	9.5
Missouri	7.2	5.9
Montana	6.2	7.9
Nebraska	4.0	6.2
Nevada	6.5	8.2
New Hampshire	4.9	2.7
New Jersey	7.2	5.6
New Mexico	7.7	8.6
New York	7.1	6.1
North Carolina	6.4	4.8
North Dakota	4.5	6.6

Ohio	8.9	9.0
Oklahoma	4.5	6.9
Oregon	8.2	7.5
Pennsylvania	7.5	7.6
Rhode Island	6.2	4.0
South Carolina	7.4	7.3
South Dakota	5.0	5.7
Tennessee	7.5	7.3
Texas	5.6	6.5
Utah	6.5	6.1
Vermont	6.2	4.6
Virginia	5.2	5.4
Washington	8.2	7.8
West Virginia	9.3	13.6
Wisconsin	6.9	6.8
Wyoming	4.5	7.8

The unemployment rates do not reveal the whole story. A complementary view of the structural changes taking place in the labor market is revealed by changes in employment over the 1980-1985 period, as shown in Table 3. The general picture that emerges is the sharp contrast between the relatively healthy job gains in the service-producing industries and the more sluggish growth in the goods-producing sector, where overall employment remains well below its pre-recession peak. Service-producing jobs are not in general substitutes for those that have been lost in goods industries in terms of occupation, location, or pay, so that many workers have not benefited from the economic expansion and have become unemployed or underemployed.

Some further light is shed on this situation in a special Bureau of Labor Statistics report on displaced workers whose jobs were abolished or whose plants shut down between January 1979 and January 1984. According to the study of the 5.1 million workers who had held their jobs for at least three years before they became displaced, 60 percent had found new jobs but nearly half reported earnings that were less than their old job. Many of these were workers who had been displaced from jobs in durable goods manufacturing. Of those who lost jobs in primary metal industries such as steel, less than half had found new jobs by January 1984. Regionally, greater proportions of displaced workers were found in the North Central and Middle Atlantic areas, reflecting the concentration of heavy industry there.

Table 3

Changes in Employment in Selected Industries

(Change from 1981 Recovery Peak to December 1985, thousands)

	1981 Peak	December 1985	Change From Peak	Percent Change
Service-producing	65,825	73,923	+8,098	12.3
Goods-producing	25,603	25,136	-467	-1.8
Manufacturing	20,342	19,420	-922	-4.5
Selected goods-producing industries with employment gains				
Lumber and Wood	691	716	+25	3.6
Furniture	473	498	+25	5.3
Electrical Machinery	2,111	2,188	+77	3.6
Publishing	1,276	1,442	+166	13.0
Plastic and Rubber Products	749	804	+55	7.3
Selected goods-producing industries with employment losses				
Mining	1,220	952	-268	-22.0
Primary Metals	1,138	802	-336	-29.5
Fabricated Metals	1,609	1,462	-147	-9.1
Non-Electrical Machinery	2,523	2,138	-385	-15.3
Chemicals	1,113	1,034	-79	-7.1

Federal Efforts

Since the 1960s the Federal government has provided financial assistance to state and local governments to (1) increase the employability of the hard to employ through training and (2) create employment opportunities in the public and non-profit sectors for the unemployed.

Despite the continued current high levels of unemployment, funding for the employment and training programs listed below has been cut 23 percent below the level of fiscal year 1985 and 16 percent below the fiscal year 1986 appropriation level (see table 4). The administration has again proposed no new funding for the Work Incentive (WIN) program, even though the Congress has voted to continue funding the program. WIN is the major Federal program providing employment, training and related services to welfare recipients. In fiscal year 1983, 250,000 WIN registrants found unsubsidized employment and in fiscal year 1984 an additional 270,000 WIN registrants are estimated to have been employed in unsubsidized jobs. The administration assumes that WIN enrollees can be served by the job training partnership program (JTPA) and the

social services program (title XX). In addition, the Reagan administration is proposing to reduce the Job Corps program by 42 percent. In fiscal year 1985, 100,000 economically disadvantaged youths received training and remedial education through this program. Further, the administration is proposing to reduce the other youth program, summer youth employment, by 33 percent. In fiscal year 1985 785,000 youths were employed through this program.

Funding for the JTPA basic training grants and the title V older workers programs would receive modest increases in fiscal year 1987 over the fiscal year 1986 appropriation, adjusted for Gramm-Rudman. In addition, the administration is proposing a one-time supplemental of $74 million in fiscal year 1986 for the dislocated workers program in order to help alleviate the severity of the dislocated worker problem, especially those affected by imports.

The budget also includes fiscal year 1986 rescissions totaling $463 million for some of the programs listed below. These rescissions include Job Corp (-$197 million), summer youth ($-208 million), WIN (-$46 million), and national programs (-$12 million).

Table 4

Employment and Training Programs
(Budget authority in millions of dollars)

	FY 1985 Actual	FY 1986 Appropriation	FY 1987 Reagan Request
Job Corps	617	613 1/	352
Summer Youth	825	636 1/	428
Basic Training Grants	1,886	1,783	1,820
National Programs	193	185 1/	210
Dislocated Workers	100	96 2/	100
Work Incentive (WIN)	267	211 1/	...
Community Service Employment for Older Americans	326	312	326
TOTAL	4,214	3,836	3,236

NOTES:

1/ Rescission request included in the budget.
2/ Supplemental appropriation request included in the budget.

G. Children

The President's budget proposes funding of $70.05 billion in budget authority and $79.30 billion in outlays in fiscal year 1987 for programs which assist children. The budget proposes reductions for every program which provides assistance to children except the low-income energy assistance program. The budget authority reduction in fiscal year 1987 from the preliminary CBO baseline is 18 percent. The reduction from actual spending levels in fiscal year 1985 is 14 percent in budget authority.

The outlay reduction in fiscal year 1987 from the preliminary CBO baseline would be 8.5 percent. Outlays would increase by 8.7 percent in fiscal year 1987 compared with actual spending in fiscal year 1985. This increase primarily reflects the spend-out of commitments for subsidized housing programs which were made in earlier years. Funding for programs which assist children is summarized in the following table.

VII. BUDGET PROCESS RECOMMENDATIONS

A. Presidential Signature on Congressional Budgets

In his budget message, the President urges, for fiscal years 1988 and beyond, changing the congressional budget resolution to a joint resolution subject to presidential signature and establishing binding expenditure subcategories within the resolution budget totals.

Participation in the congressional budget process by the President is a necessary ingredient to successful deficit reduction. There is nothing in the current congressional budget process which precludes agreement on budget policy between Congress and the President. In fact, Gramm-Rudman makes such cooperation even more important. Congress and the President already agree on the deficit target through fiscal year 1991. Implementation of any budget resolution will require the direct participation of the President.

The existing congressional budget process sets forth enforcement procedures applicable in the House and Senate. The annual budget resolution is enforced through parliamentary sanctions; points of order against consideration of measures which breach spending and revenue targets, both in the aggregate and down to subcommittee allocations.

B. Line-Item Veto

In his budget message, the President renews his request for congressional passage of a presidential line-item veto.

The President has requested this authority in past budget submissions. The President already has authority, granted him under the Impoundment Control Act of 1974, to defer or permanently cancel individual items appropriated by Congress, subject to congressional review. In fact, when he has used this power, Congress has generally gone along. In his fiscal year 1987 budget submission, the President summarizes proposals for some 79 rescissions of fiscal year 1986 budget authority.

Item veto power would not lead to a major and timely reduction in the deficit. Two major causes of high deficits, defense spending growth and certain revenue provisions, are often supported by the President and would not be addressed under the power. The vehicle could only be used to control discretionary spending--a relatively small portion of the Federal budget.

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C. Balanced Budget Constitutional Amendment

In his budget message, the President asks Congress to pass a balanced budget amendment to the Constitution.

The Balanced Budget and Emergency Deficit Control Act of 1985 became law on December 12, 1985. That law requires a balanced budget by fiscal year 1991 and sets forth procedures to implement that goal.

The renewed call for a constitutional amendment mandating a balanced budget is premature and may even detract from the current efforts to balance the budget. Before we tinker with the basic fabric of the Nation embodied in our Constitution, this new law should be given a chance to work.

If a constitutional amendment is what is ultimately desired, the experience garnered over the next few years under Gramm-Rudman will prove invaluable in drafting a workable approach.

D. Miscellaneous Proposals

In his budget message, the President also asks Congress to consider a multiyear appropriation process and to develop a capital budget.

Both of these proposals have been studied by Congress in its past reviews of the budget process. Legislation was enacted in the 98th Congress which required both Congress and the President to study the capital budget system and to include information on the capital budgets as part of the budget process (P.L. 98-501).

VIII. SPECIAL ANALYSES

A. Credit Budget

(In billions of dollars)

	FY 1985 Actual	FY 1986	FY 1987	FY 1988	FY 1989
PRESIDENT REAGAN'S 1987 REQUEST:					
Direct Loan Obligations.....	52.8	41.6	30.6	28.0	24.8
Primary Guarantee Commitments..	84.7	93.8	79.8	81.7	83.3
Secondary Guarantee Commitments	54.6	60.5	55.4	51.9	52.6
CBO BASELINE (Preliminary)					
Direct Loan Obligations.....	52.8	41.7	37.0	35.6	34.8
Primary Guarantee Commitments..	84.7	77.8	80.3	83.3	86.3
Secondary Guarantee Commitments	54.6	55.3	57.5	59.9	62.4
PRESIDENT REAGAN OVER/UNDER CBO BASELINE:					
Direct Loan Obligations.....	...	-0.1	-6.4	-7.6	-10.0
Primary Guarantee Commitments..	...	+16.0	-0.5	-1.6	-3.0
Secondary Guarantee Commitments	...	+5.2	-2.1	-8.0	-9.8

Direct loan obligations are contracts by a Federal agency to make cash payments which are to be repaid to the Government at a future date by the eligible recipient. Direct loans are reflected in the spending budget as outlays, but these disbursements are offset by loan repayments.

Primary loan guarantee commitments are contractual commitments by a Federal agency to assure the repayment, in whole or in part, of a loan held by the public. The guarantee does not directly affect Federal outlays unless the borrower defaults and the Government has to repay the lender.

Secondary loan guarantee commitments are contractual commitments by a Federal agency to assure the repayment of a loan previously guaranteed by another Federal agency in some other form. Secondary guarantees do not increase the contingent liability of the Federal Government.

HIGHLIGHTS

President Reagan's 1987 credit budget proposes $30.6 billion of new direct loan obligations, $79.8 billion of new primary loan guarantee commitments, and $55.4 billion of new secondary loan guarantee commitments. These requested amounts are below the preliminary 1987 CBO baseline estimates for each category. The new direct loan request is 17 percent below the preliminary CBO estimate of $37.0 billion for 1987. The new primary guarantee request is less than one percent below the preliminary 1987 CBO baseline estimate of $80.3 billion. The new secondary

loan guarantee request is 4 percent below the preliminary 1987 CBO baseline estimate of $57.5 billion.

The proposed 1987 activity levels also reflect a 27 percent reduction in new direct loan obligations below the preliminary 1986 CBO baseline estimate, while small increases are proposed for the two loan guarantee categories. New direct loan obligations are proposed to decline from $41.7 billion in the preliminary CBO baseline estimate for 1986 to $30.6 billion in 1987. New primary guarantees are proposed to increase 3 percent from the preliminary CBO baseline estimate of $77.8 billion in 1986 to $79.8 billion in 1987. New secondary guarantees are proposed to increase fractionally from the preliminary CBO baseline estimate of $55.3 billion in 1986 to $55.4 billion in 1987.

The President's budget proposes to terminate, phase-out, or significantly reduce several direct loan and loan guarantee programs as part of a major initiative to diminish the Federal Government's influence in national credit markets and to help reduce non-defense Federal spending.

Major 1987 credit program highlights include:

- A proposal to terminate the USDA rural housing program and the HUD Section 202 housing for the elderly or handicapped loan program in 1986. A proposed new HUD housing voucher program would replace these programs. In 1985, $4.30 billion of new rural housing loans and $597 million of new Section 202 loans were approved.

- A proposal to eliminate all Small Business Administration (SBA) direct loan and loan guarantee programs and to transfer the SBA loan portfolio to the Treasury Department for liquidation. In 1986, SBA will provide an estimated $1.14 billion of new direct loans and $2.95 billion of new loan guarantees.

- An increase in the Federal Housing Administration lump sum mortgage insurance premium from 3.8 percent up to 5.0 percent to provide additional protection against defaults because of riskier loans and slower appreciation of home values. In addition, the administration proposes to study the option of selling the FHA to the private sector.

- A phase out by 1991 of new direct farm operation and ownership loans with corresponding increases in guaranteed loans. For 1987, $1.50 billion of new direct loans and $2.50 billion of loan guarantees are requested.

- The elimination of Export-Import Bank direct loans in 1987 ($1.06 billion in 1986) to be replaced with a new $100 million interest subsidy program for export financing. Loan guarantees would be increased from $11.5 billion in 1986 to $12.0 billion in 1987.

- Elimination of the Overseas Private Investment Corporation direct and guaranteed loans by 1989.

- Phase-out of all Rural Electrification Administration loans by 1990, including a $965 million reduction in 1987 from the 1986 total of $3.22 billion of new direct loans down to $2.25 billion in 1987.

- Proposed legislation to reduce short term CCC export credit guarantees from $5.0 billion level mandated by the 1986 farm bill down to $3.0 billion in 1987.

- Proposed legislation to terminate the $500 million intermediate term CCC export credit program mandated for 1987, which was mandated by the 1985 farm bill.

- Termination of Farmers Home Administration rural development loans in 1987. The 1986 level of activity is estimated to be $734 million of new loans.

- Phase-out of the Rural Telephone Bank by 1990.

- Termination of Maritime Administration ship financing loan guarantees in 1987 and phase-out of direct loans by 1991.

PERSPECTIVES

The Balanced Budget and Emergency Deficit Control Act of 1985 (the "Gramm-Rudman" law), which was signed by the President on December 12, 1985, made several changes in the treatment and control of Federal credit assistance programs in the Congressional budget process. Aggregate and functional totals for new direct loan obligations and new primary loan guarantee commitments are to be included in Congressional budget resolutions. When a budget resolution conference report is approved, credit resources are to be allocated to the appropriate commitees just as budget authority and outlays are allocated. In addition, direct loan and loan guarantee allocations will be binding and subject to the same points of order as budget authority and outlays. Further, section 212 of the Act, creating a new section 402 of the Congressional Budget Act of 1974, provides a new point of order against the consideration of any bill, resolution, conference report, or amendment that provides new credit authority unless that new authority is subject to annual appropriations limits. Finally, the Act also provides that the Federal Financing Bank, a major Federal source of loan financing, will be included "on budget" and that its loans will be attributed to the budgets of the agencies sponsoring those loans.

G. Children

Funding for Children's Programs
(In billions of dollars)

This table includes all funding for these programs. In some cases, funding goes in part to adults. Sufficiently valid program data to permit a breakdwon by demographic group is not avilable in all cases.

	1985 Actual		1986 CBO Baseline (Preliminary)		1987 CBO Baseline (Preliminary)		1987 Administration Request	
	BA	O	BA	O	BA	O	BA	O
Elementary and Secondary Education.....	7.95	7.65	7.60	7.70	8.05	7.75	7.25	7.35
Social Services.....	7.30	6.75	7.10	7.00	7.45	7.40	6.90	6.90
Medicaid.....	21.85	22.65	24.45	24.45	26.45	26.45	24.70	24.70
Health Services.....	1.10	1.10	1.10	1.10	1.15	1.15	1.10	1.10
Subsidized Housing*....	12.35	5.30	10.10	11.85	11.25	12.40	1.30	10.40
Food Stamps.....	12.60	12.55	12.60	12.65	13.05	13.05	12.35	12.35
Child Nutrition.....	3.80	3.65	4.10	3.90	4.00	4.15	3.45	3.50
WIC.....	1.50	1.50	1.60	1.60	1.65	1.65	1.60	1.60
Public Assistance.....	8.55	8.60	9.10	9.10	9.50	9.50	8.20	8.20
Child Support Enforceme	0.65	0.60	0.60	0.65	0.75	0.75	0.75	0.75
Low-Income Energy Assistance.....	2.10	2.15	2.00	2.00	1.90	1.95	2.10	2.10
Refugee Assistance.....	0.45	0.45	0.40	0.45	0.40	0.40	0.35	0.35
TOTAL.....	80.20	72.95	80.75	82.45	85.60	86.60	70.05	79.30

* Estimates exclude amount for low-rent public housing loans which result from financing changes necessitated by 1984 revenue legislation.

B. Controllability

In dealing with high deficits and plans to reduce them, an understanding of the capacity of Congress to control spending in any given fiscal year is necessary.

About three-fourths of the outlays in President Reagan's fiscal year 1987 budget are mandatory under existing law, i.e., "relatively uncontrollable" through the annual appropriations process. This means that, as a result of existing law, funds have already been committed. Even if no laws of any kind were enacted this session, these funds would be spent. To reduce this spending, the President and Congress would have to amend or repeal existing law. This portion of the budget has been growing in recent years.

In contrast, the discretionary portion of the budget has been shrinking over the last decade. In fiscal year 1976 the discretionary part of the budget was 33 percent of total outlays, while the fiscal year 1987 level is 23 percent, in spite of large defense increases.

These numbers are from President Reagan's 1987 budget; they differ in a number of key respects from those that Congress would use. OMB analyzes Presidential control over outlays under existing law, while Congress would analyze congressional control under existing law. These differ because there are programs over which the President has substantial control under existing law even though Congress does not. Most such programs involve offsetting receipts. An example is "Rents and Royalties on the Outer Continental Shelf". The President has some discretion on the timing of OCS auctions, while the Congress has none under existing law, so this $5.3 billion item is not controllable by Congress.

Mandatory Spending

The President's budget divides mandatory outlays for fiscal year 1987 into three parts: 1) Payments for Individuals ($420.9 billion); 2) Other Open-Ended Programs and Fixed Costs ($157.5 billion); 3) Outlays from those prior-year contracts and obligations that flow from otherwise discretionary appropriations ($185.0 billion). All three categories of uncontrollable spending have grown rapidly in the last decade.

1. Payments for Individuals consist of cash payments by the Federal Government for which no goods or services are purchased. They are often called "transfer payments". Examples are Social Security, Unemployment Compensation, and Federal Military and Civilian Retirement. Outlays for this category total $420.9 billion in fiscal year 1987, a 158 percent increase since fiscal year 1976. Most payments for individuals are indexed directly or indirectly to the CPI, and many have experienced great growth in the number of eligible recipients, particularly as the elderly population grows.

   The Social Security and Railroad Retirement System is the largest element of this category, with outlays of $213.1 billion in fiscal year 1987. Medicare/Medicaid totals $102.5 billion, and Federal

Employee Retirement programs total $55.2 billion. Most payments for individuals are entitlements, but this category also includes discretionary payments such as Pell grants to college students.

2. Other Open-Ended Programs and Fixed Costs are for a wide variety of different programs, including many offsetting receipts. Net Interest, totaling $147.3 billion, dominates this category. (The President includes the Legislative and Judicial Branches in this category, totaling $3.2 billion.)

3. Outlays from Prior-Year Discretionary Appropriations is money that entered the pipeline in some previous year, but is just now flowing out. While these outlays are for discretionary programs, the outlays are mandatory because they result from existing law -- in this case, appropriations enacted in prior years. Of the $185.0 billion in this category, about 58 percent is for National Defense. In theory such spending could be reduced by rescinding existing appropriations. In many cases the funds in the pipeline are already contractually committed, so rescissions may not be practical. However, Congress has control right now over such future outlays since it can determine on an annual basis the appropriations that enter the pipeline. This is one reason why Congress has more long-term control than short-term control over outlays, and why planning now for outyear spending is recommended in the President's budget.

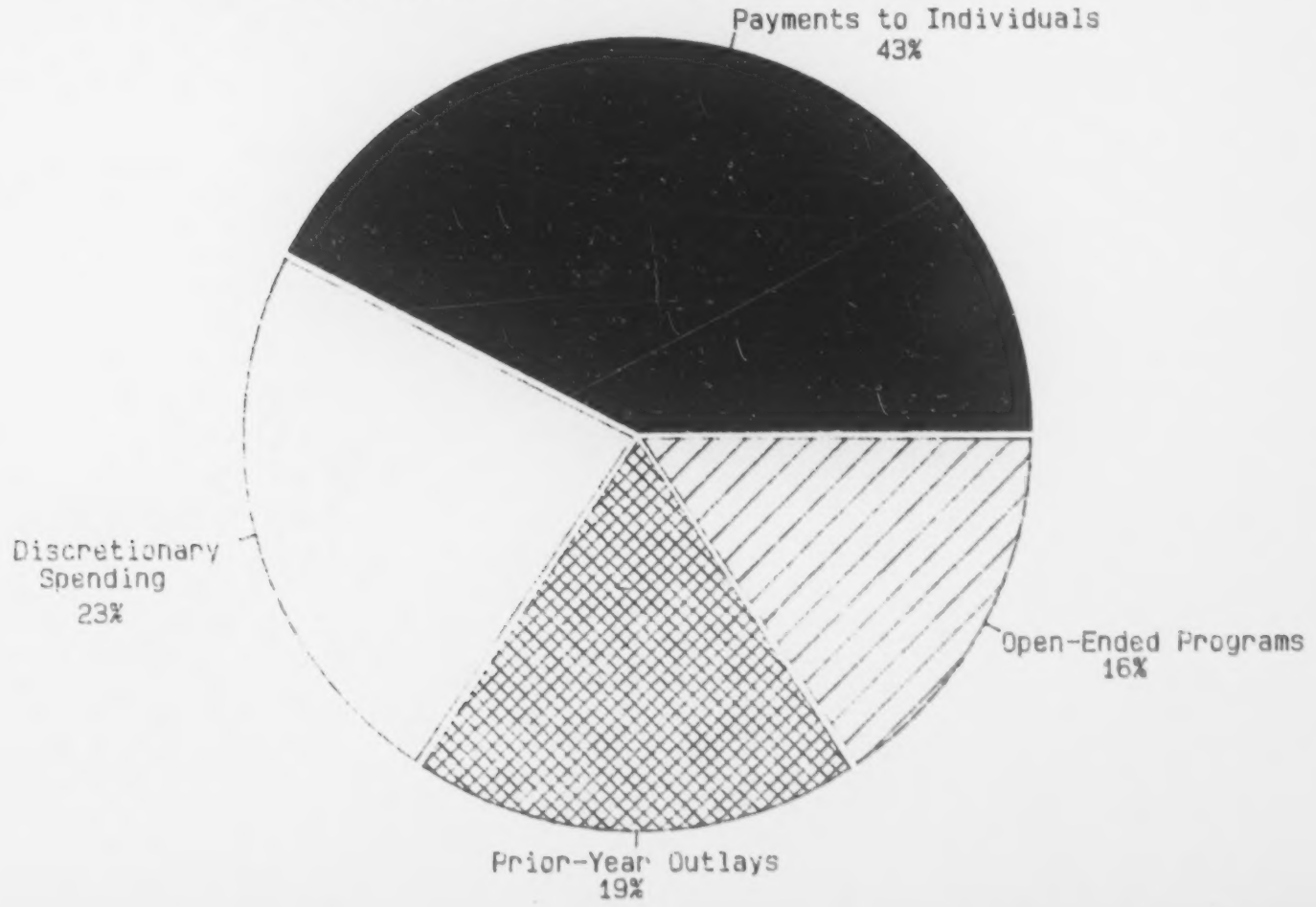
Proposed Legislation

The President's budget proposes legislation that would amend many of the existing laws that established mandatory programs. Through this method, he proposes to reduce 1987 spending for such programs by about $7 billion. The largest cuts are in Medicare, Medicaid, Federal retirement, and nutrition programs.

Discretionary Spending

The remaining outlays in the President's fiscal year 1987 budget -- about $230.7 billion -- are discretionary; their level will be determined by appropriations action this session. About 68 percent of this amount is for National Defense. In the 1987 budget the President proposes an overall reduction in all discretionary outlays; they would be about $7 billion lower than in 1986. Since defense outlays are increasing, the civilian portion is shrinking significantly. Nondefense discretionary outlays are estimated by the President to be about $19 billion lower in 1987 than in 1986.

CONTROLLABILITY OF FEDERAL OUTLAYS
PRESIDENT'S FY 1987 BUDGET



C. Infrastructure And Capital Programs

The President is required to submit to Congress an analysis of all capital programs in the budget by the 1984 Federal Capital Investment Program and Information Act. This submission should detail the amounts for all capital spending in the budget and also provide some analysis of the programs and their needs as well as 10 year projections of these needs. Following is a table including the major capital programs contained in the special analysis scheduled for later transmittal by the Administration. This list of programs represents over 90 percent of the spending which will be reflected in the President's special analysis as required by the 1984 Act noted above.

Funding for these programs would decrease in the 1987 budget to $37.75 billion in 1987, a 22 percent decrease from fiscal year 1986 funding of $48.25 billion. However, within this total, the reduction in domestic programs between 1986 and 1987 would be 30 percent. The 30 percent reduction in domestic capital programs is partially offset by increases in military construction and family housing of 27 percent and an increase of 81 percent in State Department construction abroad related to terrorist activities.

Some of the largest decreases between 1986 and the 1987 budget request for civilian programs are: EPA sewage treatment construction grants (24 percent), Soil Conservation Service (22 percent), capital activities of the National Oceanic and Atmospheric Administration (21 percent), National Park Service (64 percent), federal aid highways (13 percent), Coast Guard aquisition and construction (63 percent), Bureau of Indian Affairs Construction (42 percent), Community Development grants (29 percent), Veterans Administration construction (34 percent), and rental related subsidized housing (71 percent).

Other capital programs would be eliminated in the budget. These include: the ASCS Agricultural Conservation Program, housing for the elderly and handicapped, Amtrak, Community development grants, remaining subsidized housing, economic development assistance programs, rural water and waste disposal grants, Appalachian Regional Development Commission capital activities, Urban Development grants, and Indian Health facilities construction.

MAJOR INFRASTRUCTURE AND CAPITAL INVESTMENT PROGRAMS

(Budget authority in millions of dollars)

Program	FY 1986 Preliminary CBO Baseline	President's Budget FY 1987	FY 1988	FY 1989
Military Construction	5,281	6,743	8,999	8,982
Family Housing	420	509	611	677
Department of State Acquisition of buildings abroad.	194	1,048	762	718
General science and research activities	466	542	571	596
NASA	1,171	1,495	1,374	1,410
Energy Supply, R&D activities	205	150	220	226
Construction, WAPA	80	98	125	131
EPA construction grants	2,374	1,800	1,200	600
Soil Conservation Service	557	436	351	351
Bureau of reclamation construction	499	577	737	765
ASCS ag. consv. program	181	...	...	...
Forest Service construction	213	195	195	195
National Forest System	622	551	551	551
Abandoned Mine Reclamation Fund	197	191	191	191
Corps of Engineers	1,073	1,237	1,316	1,326
NOAA ops., res. and facilities	281	221	237	233
National Park Service	203	74	74	74
Business loan and investment fund	36	555	45	30
Housing for Elderly and handicapped	584	...	...	...
Rural Housing Insurance Fund	1,559	1,289	1,183	1,185
Federal Aid Highways	14,684	12,770	12,770	12,770
Airport Grants	973	1,017	500	500
Aviation facilities and equipment	950	825	1,164	1,164
Mass Transit	3,565	1,220	1,220	1,220
Amtrak	562	...	...	...
Coast Guard Acq., construction and improvement	208	77	275	285
Subsidized housing .(rental)	144	...	...	...
Economic Development Assistance programs	176	...	...	...
Bureau of Indian Affairs construction	101	59	59	59
Rural Water and Waste disposal grants	109	...	...	...
Appalachian Regional Development Commission	115	...	...	...
Community Development grants	2,990	2,127	2,740	2,850
Urban Development Action grants	316	...	...	...
Indian Health Facilities	48	...	...	...
VA Construction	617	408	704	706
Subsidized housing	6,487	1,523	3,310	2,998
TOTAL	48,241	37,737	41,484	40,793

D. Initiatives and Program Expansions

Although many domestic programs are being severely constrained because of the high deficit, the President's budget does contain a few legislative initiatives and program expansions.

- Executive Office of the President

The fiscal year 1987 budget includes a request for $117 million to fund the Executive Office of the President. This request is $6 million, or 5 percent, over the current 1986 funding and $5 million, or 4 percent, over the preliminary CBO baseline estimate for 1987 for the Executive Office of the President. Within the Executive Office of the President, $41 million is requested for the Office of Management and Budget in 1987. This request is $3 million, or 8 percent, above the preliminary CBO baseline estimate for 1987.

- Fair Export Financing Program

The fiscal year 1987 budget proposes that $300 million be appropriated for a new program of concessionary export financing. The program would be used to help U.S. exporters meet unfair competition in the area of international trade financing.

- Embassy Security Enhancement

The budget requests a fiscal year 1986 supplemental appropriation of $0.7 billion to begin a multi-year, multi-billion dollar program to increase the security for diplomatic missions against international terrorism. The full cost of the program is estimated to be $4.4 billion over the next five years. For fiscal year 1987 the budget proposes $1.75 billion for this program which is $1.3 billion above the current 1986 level and $1.3 billion above the preliminary 1987 CBO baseline.

- Teacher Training and Improvement

The fiscal year 1987 budget proposes to replace the existing math-science teacher training program and two smaller teacher programs (total fiscal year 1986 funding is $52 million) with a new and broader teacher training and improvement program. The fiscal year 1987 funding for this program would be $75 million, which is $23 million above the 1986 level and $21 million above the preliminary 1987 CBO baseline. The new program would not be limited to teachers in math and science but open to all teaching disciplines.

- Internal Revenue Service

The fiscal year 1987 budget proposes a significant expansion of IRS funding starting in 1986 to improve the processing of tax returns and to expand the collection of unpaid taxes. The budget requests $4.10 billion for IRS in 1987, which is $612 million over the current 1986 funding and $564 million above the preliminary CBO baseline estimate for 1987. In addition, the budget includes a $340 million supplemental appropriation request for 1986. The long-range projections of the administration also reflect continued real growth in IRS funding in 1988 and 1989.

- Medicare Vouchers

The fiscal year 1987 budget proposes $70.25 billion for medicare and proposes a new program to allow medicare beneficiaries to elect to receive vouchers which may be used to purchase private health insurance. The vouchers would equal 95 percent of the medicare per capita cost. The proposal would cost $50 million in 1987 and $150 million over three years.

- Space Station

The fiscal year 1987 budget proposes $410 million for the manned space station program in 1987 to initiate the development stage of the station. The budget request is $214 million above the 1986 level and $206 million above the preliminary 1987 CBO baseline. The budget request states that the space station has a "planned start of initial operating capability in the mid-1990's."

- National Science Foundation (NSF)

The fiscal year 1987 budget proposes a funding level of $1.5 billion for the National Science Foundation, which is an increase of $185 million over the 1986 level and $116 million above the preliminary 1987 CBO baseline for basic research. The National Science Foundation primarily supports research at academic institutions through grants to individual scientists.

- National Aeronautical Research and Development

The fiscal year 1987 budget proposes $706 million in budget authority for aeronautical research and development by the National Aeronautics and Space Administration (NASA). This amount represents a $100 million increase over the preliminary CBO baseline for fiscal year 1986 and $77 million above the preliminary 1987 CBO baseline. The increase is primarily for initiation of a new joint NASA/Department of Defense program of research and advanced technology development in hypersonic flight. The new technology was mentioned by the President in his State of the Union address in terms of private industry use of the "orient express" plane that may be capable of flying from the U.S. to the Orient in a few hours.

- International Security Assistance

The fiscal year 1987 budget continues the administration's history of recommending major annual increases in International Security Assistance. The fiscal year 1987 budget request is $11.25 billion, which is $717 million above the 1986 level and $896 million above the preliminary 1987 CBO baseline, an 8.6 percent increase.

- Federal Law Enforcemment Activities

The fiscal year 1987 budget includes a proposal to significantly increase funding for law enforcement activities. The fiscal year 1987

funding request is $3.95 billion, which is $256 million above the 1986 level and $194 million, or 5 percent, above the preliminary 1987 CBO baseline. Most of the increase is associated with an expansion of drug investigations and foreign counter-intelligence activities.

- Student Loan Initiative

The 1987 budget includes a proposal to restructure the national direct student loan (NDSL) program to make the repayment schedule based upon an individual's income and to increase the amount of loan availability. The budget authority amounts below reflect the program level increase over the preliminary baseline estimates for the current NDSL program. (The actual budget authority/appropriation request is lower in each instance due to a proposal to allow offsetting collections to be used as new capital contributions in lieu of reverting to the Treasury.)

- Enterprise Zone Legislation

The fiscal year 1987 budget states that the President intends to repropose enterprise zone legislation at a later date. The concept involves having States and localities designate distressed areas to be eligible for favorable federal tax treatment and additional special support from the local government. Past estimates of this legislation have assumed a $1.3 billion revenue loss over three years assuming a January starting date.

The following tables compare the President's program initiatives with the preliminary CBO baselines for 1986, 1987 and the outyears.

1987 BUDGET INITIATIVES AND EXPANSIONS[1/]

(In millions of dollars)

	FY 1987		FY 1988		FY 1989	
	BA	O	BA	O	BA	O
Fair Export Financing Program...	+300	+16	...	+56	...	+64
Embassy Security Enhancement....	+1,276	+563	+781	+668	+687	+915
Teacher Training and Improvement	+21	-1	+18	+15	+17	+18
Internal Revenue Service.....	+564	+488	+857	+801	+1,051	+992
Executive Office of the President	+5	+4	+3	+2	+3	+2
Medicare Vouchers.....	NA	50	NA	50	NA	50
Space Station.....	+206	+141	+788	+369	+1,579	+1,039
National Science Foundation (NSF)	+116	+91	+98	+80	+66	+64
NASA Aeronautical Research and Development.....	+77	+16	+55	+51	+35	+45
International Security Assistance	+896	+2,673	+885	+2,200	+514	+1,639
Federal Law Enforcement Activities	+194	+120	+218	+133	+178	+86
Student Loan Initiative.....	...	-146*	+36	-67	+74	-19
Enterprise Zone Legislation:	Currently the revenue projections do not reflect this legislation.					

*Reflects outlay efffects of the 1986 rescission proposal and the new program start-up.

1/ This table displays the difference between the budget request and the preliminary 1987 CBO baseline.

PROGRAM INITIATIVES AND EXPANSIONS

(In millions of dollars)

Program	Preliminary 1986 Baseline		Preliminary 1987 Baseline		1987 Budget Request		Budget Request Over(+)/Under(-) 1986 CBO Baseline		Budget Request Over(+)/Under(-) 1987 CBO Baseline	
	BA	O	BA	O	BA	O	BA	O	BA	O
Fair Export Financing Program...	...	...	...	...	300	16	+300	+16	+300	+16
Embassy Security Enhancement....	452	466	471	475	1,747	1,038	+1,295	+572	+1,276	+563
Teacher Training and Improvement	52	79	54	63	75	62	+23	-17	+21	-1
Internal Revenue Service.....	3,486	3,482	3,534	3,535	4,098	4,023	+612	+541	+564	+488
Executive Office of the President	110	111	112	112	117	116	+7	+5	+5	+4
Medicare Vouchers.....	...	...	...	...	NA	50	NA	+50	NA	+50
Space Station.....	196	153	204	195	410	336	+214	+183	+206	+141
National Science Foundation (NSF)	1,294	1,293	1,363	1,335	1,479	1,426	+185	+133	+116	+91
NASA Aeronautical Research and Development.....	607	615	629	636	706	652	+99	+37	+77	+16
International Security Assistance	10,555	9,307	10,376	8,266	11,272	10,939	+717	+1,632	+896	+2,673
Federal Law Enforcement Activities	3,687	3,698	3,749	3,737	3,943	3,857	+256	+159	+194	+120
Student Loan Initiative.....	182	188	192	183	190[1/]	37	+8	-51	-2	-146
Enterprise Zone Legislation:	Currently the revenue projections do not reflect this legislation.									

1/ Includes offsetting collections which will be used for new capital contributions.

IX. HIGHLIGHTS AND ISSUES BY FUNCTION

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 050: NATIONAL DEFENSE

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	294.65	286.10	320.35	341.55	363.25
Outlays	252.75	265.85	282.25	299.15	322.30
CBO BASELINE (Preliminary)					
Budget Authority	294.65	286.75	301.05	314.80	329.60
Outlays	252.75	269.45	284.20	296.35	310.95
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-0.65	+19.30	+26.75	+33.65
Outlays	...	-3.60	-1.95	+2.80	+11.35

HIGHLIGHTS

Funds in this function are to equip and maintain the military forces of the United States, and to finance defense-related activities of the Department of Energy. Major areas of funding include pay and benefits to active military and civilian personnel, including an accrual charge towards military retirement benefits; research, development and procurement of weapons systems and supporting equipment; military construction including family housing; and operations and maintenance of the defense establishment. Funding is also provided for the development and procurement of nuclear weapons and naval reactors.

Highlights of the major programs in this function are as follows:

- Overall Funding--President Reagan's 1987 budget recommends $320.35 billion in budget authority and $282.25 billion in outlays, an increase of $34.25 billion in budget authority and $16.40 billion in outlays over fiscal year 1986. National Defense outlays would absorb 28.4 percent of the Federal budget and 6.2 percent of the Gross National Product. The distribution of the budget increase is shown in the following chart.

Defense Appropriation Title	Budget Authority in billions of dollars 1985 Actual	1986	1987	Change (FY 86-87)
Military Personnel	67.8	67.7	74.2	+6.5
Operation and Maintenance	77.8	74.9	85.8	+10.9
Procurement	96.8	92.6	95.8	+3.2
Research, Development, Test and Evaluation	31.3	33.7	41.9	+8.2
Military Construction	5.5	5.3	6.7	+1.4
Family Housing	2.9	2.8	3.4	+0.6
Revolving, Management Funds/Other	4.7	1.4	0.5	-0.9
Pay Raise	...	...	3.3	+3.3
Total Department of Defense	(286.8)	(278.4)	(311.6)	(+33.2)
Atomic Energy Defense Activities	7.3	7.2	8.2	+1.0
Defense Related Activities	0.6	0.5	0.5	...
Total National Defense	294.7	286.1	320.3	+34.2

- Real Growth--The fiscal year 1987 budget request continues the defense build-up of the last several years. Real growth for the entire function is projected to be 8.3 percent, and nominal growth to be 12.0 percent.

Nominal Growth by Appropriation Title, Fiscal Year 1986-1987 Budget Authority

	Dollar Growth in Billions	Percent Nominal Growth
Military Personnel*	+9.1	+13.4
Operations and Maintenance	+10.9	+14.6
Procurement	+3.2	+3.5
RDT&E	+8.2	+24.3
Family Housing, Military Construction, and Other	+1.8	+18.9

* Including the proposed military pay raise.

- Personnel Level--The DOD civilian workforce is projected to grow by 4,000 in fiscal year 1987 to 1,114,000. The active military shows an increase of 14,000 for a total strength of 2,181,000. This military end strength represents an increase of approximately 118,000 over the fiscal year 1980 level. Reserve personnel strength increases by 52,000 to a total of 1,186,000.

- Pay Raise--The President proposes a military pay raise of four percent in October 1986. A three percent pay raise for civilian personnel is reflected in the budget. The civilian pay raise would occur in January 1987.

- Investment--As displayed in the previous charts the administration is requesting substantial increases in the investment accounts (Procurement, R&D and MilCon). The fiscal year 1987 funding level of $144.5 billion represents a nominal increase of 9.7 percent over the fiscal year 1986 level.

- Major Systems--The Navy is requesting funds for 21 new ships and three ship conversions. Funding is requested for continued acquisition of one Trident submarine per year, and funding for the Trident II missile increases significantly to $3.1 billion. Funding for the F/A-18 aircraft totals $3.5 billion.

  The Air Force is requesting $3.9 billion for the acquisition of 216 F-16 fighter aircraft and $2.3 billion for the acquisition of 48 F-15 fighter aircraft.

  The Army plans to buy 840 M-1 tanks, 870 Bradley Fighting Vehicles and 144 AH-64 attack helicopters, as part of its continuing force modernization program. $1.1 billion has been requested for the Patriot Missile. Funding of $1.1 billion is requested for the various unclassified cruise missile programs.

- Research, Development, Testing and Evaluation--This title projects the largest percentage growth in the budget this year. Nominal growth is 24.3 percent, and real growth would be 19.7 percent. Much of this is due to the increase in the Strategic Defense Initiative, which would increase by $2.0 billion over the fiscal year 1986 level. This accounts for almost one-fourth of the total dollar increase in this title. Other large increases occur in strategic and classified programs.

- Atomic Energy Defense Activities--The administration requests $8.2 billion for atomic energy defense activities in fiscal year 1987, up from $7.2 billion in fiscal year 1986 and $7.3 billion in fiscal year 1985. These increases provide for increased nuclear warhead production for current and new weapons systems.

MAJOR ISSUES

1. Real Growth

The overriding issue will again be the size of the defense funding increases. The proposed $34.3 billion increase over the fiscal year 1986 level comes during a time of massive Federal budget deficits, after several years of significant real growth in defense expenditures, and at a time when the requests for other agencies have been frozen or reduced. Is a slower, more gradual build-up justified? Does the threat justify growth of this magnitude? Can our industrial capacity accommodate this growth efficiently? Can the Defense Department effectively and efficiently manage the funds? Also at issue is whether our allies are bearing a fair share of the free world's defense costs.

2. Strategic

Funding is provided for the "Star Wars" strategic missile defense plans, the Stealth bomber and the "Midgetman" missile. These programs are projected to grow rapidly in the outyears. Most other strategic initiatives of this administration are already underway. The budget for these programs is significantly increased in the fiscal year 1987 request.

3. Investment/Readiness

As the previous table displays, significant growth occurs in the investment accounts (Procurement, R&D, and Milcon). There is concern that the administration's defense program is not properly balanced between modernization and readiness. The accounts which most directly reflect readiness (operations and personnel) have not been growing and are not projected to grow as rapidly as the investment accounts. Will we be able to operate and maintain the weapons currently being developed and procured or are the operations costs in future years understated?

4. Major Systems

Several major systems continue to raise questions of cost growth, reliability, and combat effectiveness, including the AEGIS Cruiser, F-18 aircraft, F-15 aircraft, the Bradley Fighting Vehicle, the Air Force AMRAAM missile, the Patriot missile system, and the Army Helicopter Improvement Program.

5. Cost Growth

The Defense Department has continually experienced significant cost overruns. The Department claims it has made significant progress in this area, and some indicators tend to support this. However, there are reports which indicate that the administration has substantially understated the outyear costs of its procurement of major weapon systems.

6. Waste, Fraud and Mismanagement

As the defense build-up continues, it is necessary to ensure that the Defense Department is managing the build-up efficiently and effectively and has reduced waste, fraud and mismanagement to the absolute minimum. Continuing reports highlighting excessive spare parts costs and procurement mismanagement indicate that problems still exist in this area which will require review during the fiscal year 1987 budget deliberations.

7. Pay Raise

The administration has requested a 4.0 percent pay raise for military personnel in October 1986 and a 3.0 percent pay raise for civilian personnel effective January 1987. The equity difference in the pay requests will be an issue before the Congress. Military personnel have experienced greater pay raises over the past several years than Federal civilian employees.

8. Personnel

Military personnel would increase by 14,000 over the fiscal year 1986 level to 2,181,000. This would be a 118,000 increase over the fiscal year 1980 level. Civilian personnel would increase by 4,000 to 1,114,000. This represents an 123,000 increase over the fiscal year 1980 level.

9. Department of Energy, Defense-Related

Increases to atomic energy defense activities have averaged close to 15 percent per year since 1980. This program will be closely examined to ensure that it is compatible with the Department of Defense programs it supports.

10. Outlay estimates

It appears that the Department of Defense may have underestimated outlays by approximately $4 billion in fiscal year 1986 and by as much as $15 billion in fiscal year 1987. The accuracy of DOD outlay estimates will be a major issue as Congress continues to concentrate on deficits.

PERSPECTIVES

The fiscal year 1987 program continues the substantial real growth rates for the National Defense function. As shown in the second chart below, these rates of real growth affect all defense categories. However, it should be noted that the larger areas of growth are in the investment accounts (research and development, and procurement). This could cause problems in the readiness area, as large quantities of sophisticated new weapons systems are deployed with relatively smaller increases in the operation and support costs. Additionally, the fact that investment programs spend out slowly means that significant outlay increases will occur in the future and Congress will have little or no control over these outlay increases. While the extent of such problems cannot be projected at this time, historical data indicates it should be an area of concern and there is no indication in the Defense budget that this situation has been planned or budgeted for properly.

Defense Budget

- Real Growth (budget authority)

FY 1980	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985
2.1%	12.7%	12.3%	9.1%	5.3%	7.3%

FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991
-5.9%	8.3%	3.0%	2.9%	2.8%	2.6%

- Nominal Growth (budget authority)

FY 1980	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985
13.8%	25.1%	20.3%	13.2%	8.2%	11.1%

FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991
-2.9%	12.0%	6.6%	6.4%	5.9%	5.5%

- National Defense Outlays as Percentage of Gross National Product

FY 1980	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985
5.0%	5.3%	5.9%	6.3%	6.2%	6.4%

FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991
6.3%	6.2%	6.1%	6.1%	6.1%	6.2%

- National Defense Outlays as Percentage of Federal Budget

FY 1980	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985
22.7%	23.2%	24.8%	26.0%	26.7%	26.7%

FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991
27.1%	28.4%	29.1%	30.3%	31.5%	32.6%

- Budget Authority by Activity and Title

	(In billions of dollars)						
	Actual					President's Budget Request	
	1980	1981	1983	1984	1985	1986	1987
Military Personnel....	41.1	48.5	61.1	64.9	67.8	67.7	74.2
Operations and Maintenance.....	46.4	55.5	66.5	71.0	77.8	74.9	85.8
Procurement.....	35.3	48.0	80.4	86.2	96.8	92.6	95.8
Research, Development Test and Evaluation.....	13.6	16.6	22.8	26.9	31.3	33.7	41.9
Military Construction.....	2.3	3.4	4.5	4.5	5.5	5.3	6.7
All Other.....	2.0	4.0	3.4	3.2	7.6	4.2	3.9
Pay Raise.....	...	...	...	...	...	...	3.3
Total (Function 051)..	(140.7)	(176.0)	(238.7)	(258.2)	(286.8)	(278.4)	(311.6)
Atomic Energy Defense Activities (Function 053).....	3.0	3.7	5.7	6.6	7.3	7.2	8.2
Defense Related Activities (Function 054).....	0.2	0.3	0.6	0.4	0.6	0.5	0.5
Total National Defense (Function 050).....	143.9	180.0	245.0	265.2	294.7	286.1	320.3

- Funding Growth in Major Systems

The number of systems costing $1 billion per year or more has greatly increased in the last few years. In 1981, there were nine systems budgeted for $1 billion or more, and total funding for these systems was $14 billion. In 1987 there are 16 unclassified systems and their funding will absorb $37.4 billion.

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 150: INTERNATIONAL AFFAIRS

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	26.45	20.80	22.65	21.55	21.45
Outlays	16.20	17.15	18.60	18.25	18.05
CBO BASELINE (Preliminary)					
Budget Authority	26.45	19.20	19.85	20.00	24.20
Outlays	16.20	17.10	14.90	15.05	15.20
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	+1.60	+2.80	+1.55	-2.75
Outlays	...	+0.05	+3.70	+3.20	+2.85

HIGHLIGHTS

This function includes programs for the conduct of foreign affairs, including embassies and other diplomatic missions abroad; foreign economic and financial assistance, including security assistance to Israel and Egypt; and international financial programs such as the Export-Import Bank, foreign military sales made through the military sales trust fund, and United States participation in the International Monetary Fund.

Highlights of the major programs in this function are as follows:

- Foreign Economic Assistance Programs--President Reagan's fiscal year 1987 budget proposes a program level of $4.90 billion, compared to the fiscal year 1986 level of $4.65 billion and the fiscal year 1987 current policy level of $5.05 billion. The proposed budget would continue most of these programs at about the post-sequestration fiscal year 1986 level in 1987, but projects real declines in fiscal years 1988 and 1989.

- Security Assistance Programs--The fiscal year 1987 budget proposes a real program increase to a level of $11.25 billion, compared to the fiscal year 1986 level of $10.25 billion and the fiscal year 1987 current policy level of $10.40 billion.

- Export-Import Bank--The fiscal year 1987 budget again proposes to end the on-budget Export-Bank direct loan program. The program would be replaced with a program of interest subsidies to private banks when those banks agree to make funds available for below-market-rate loans to foreign buyers of U. S. goods.

- Fair Export Financing Program--The President is proposing $300 million be made available in fiscal year 1987 for a new program of concessionary export financing. The program would be used to help U.S. exporters meet unfair international trade competition.

- Embassy Security Enhancement--The President's budget proposes a fiscal year 1986 supplemental of $0.70 billion to begin a multiyear, multi-billion dollar, program to increase the security of our diplomatic missions against international terrorism. The five year cost of the program is estimated at $4.4 billion.

MAJOR ISSUES

1. Foreign Economic Assistance

The President's fiscal year 1987 request of $4.90 billion for these programs is $0.15 billion below the level projected in the preliminary estimate of the current policy baseline. Funding is requested to meet existing U.S. commitments for contributions to the multilateral development banks, but the projections assume real declines in funding levels for these banks in the out-years. For U.S. bilateral programs administered by the Agency for International Development, including food assistance programs, the budget provides about the same funding levels for fiscal years 1987, 1988, 1989, with little or no allowance for inflation. While the fiscal year 1987 funding levels merely continue the administration's policy of real funding reductions in this area, the recent history of special supplemental requirements for famine relief in Africa, and Congressional funding initiatives such as the Special Facility for Sub-Saharan Africa, indicate that the out-year spending projections may be understated.

2. Security Assistance

The President's fiscal year 1987 security assistance estimate does not appear to reflect any of the budget constraint required to achieve reduced budget deficits. It appears that the expectations of security aid recipients has not been curtailed and the administration has not indicated that it plans to retrench in this area. While the levels of assistance to Israel and Egypt is held to the fiscal year 1986 appropriated levels, the President's budget proposes that aid to other recipient countries be increased over the 1986 appropriations by $1.05 billion or 20 percent. Consequently, the Congress will have to decide whether to accept the President's high priority ranking for security assistance or whether these accounts should be subjected to the budget discipline accorded other Federal spending.

3. Export-Import Bank

The President's fiscal year 1987 budget again proposes to change the financing arrangements for the Bank's direct loan program. Currently, the Eximbank borrows from the Federal Financing Bank and uses those funds to finance its lending programs. For fiscal year 1987, the Congress will have to decide whether it will continue the Bank's current arrangements or accept the President's proposal to subsidize private sector lending institutions that make funds available for below-market-rate export loans.

PERSPECTIVES

Foreign Aid Program

The President's fiscal year 1987 budget request continues to support real increases in security assistance programs while projecting real declines in foreign economic assistance levels. Although Congress has not provided all of the requested increases in security assistance programs, it has accepted most of the President's proposals for reduced levels of funding for economic assistance programs. Consequently, there has been a continual shift of emphasis from economic and food assistance programs in favor of military assistance during the past four fiscal years. In addition, during this same period the levels of military and economic assistance for Israel and Egypt have grown substantially and claimed a larger proportion of the funds available for foreign assistance.

Export-Import Bank

Although the Export-Import Bank's direct loan levels have decreased substantially from the $5.4 billion in fiscal year 1981, this decrease has not resulted from the administration's reduced budget proposals for this program. In fact, the appropriation ceiling in fiscal year 1985 was $3.9 billion, and the Bank failed to lend even one quarter of the funds it had available. A more important factor in the decline of Export-Import Bank activity levels may have been the problems caused for U.S. exports by the increasing exchange value of the dollar. In that connection, the recent and continuing decline in the dollar's international exchange rate should increase the level of U.S. exports and increase the demand for export financing resources.

The administration's new proposal to finance the Bank's direct loan activities by using private sector lenders rather than the Federal Financing Bank will increase the cost of the program without any increase in program scope. It is difficult to find any justification for such a change in financing arrangements, other than the administration's claim of an apparent reduction in budget outlays. However, a preliminary analysis of the new financing arrangement indicates that budget outlays will not necessarily decrease if this arrangement were adopted, and may actually increase.

FUNCTION 050 NATIONAL DEFENSE:

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Military Personnel.....	67.75	67.85	67.65	71.70	67.65	71.45	67.80	67.20	72.75	71.70	74.20	73.60
Operations & Maintenance....	77.80	72.35	74.80	74.10	74.85	74.15	76.75	75.20	74.80	73.65	85.75	80.85
Procurement.....	96.85	70.40	93.30	78.05	92.60	75.70	96.80	85.05	93.30	84.60	95.80	76.70
Research, Development, Test and Evaluation.....	31.35	27.10	33.60	30.35	33.75	28.70	34.40	32.20	33.60	31.50	41.95	31.60
Military Construction and Family Housing.....	8.40	6.90	8.10	7.65	8.10	7.00	8.35	7.90	7.10	7.80	10.15	7.10
Other DOD*.....	4.65	0.75	1.55	0.20	1.45	1.45	9.05	8.80	2.10	-0.25	3.75	4.40
Atomic Energy Defense Activities.....	7.30	7.10	7.25	7.15	7.25	7.15	7.40	7.35	7.25	7.25	8.25	7.70
Defense-Related Activities..	0.55	0.30	0.50	0.25	0.45	0.25	0.50	0.50	0.95	0.70	0.50	0.30
TOTAL.....	294.65	252.75	286.75	269.45	286.10	265.85	301.05	284.20	291.85	276.95	320.35	282.25

* Includes allowances for fiscal year 1987 military and civilian pay raises.

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 250: GENERAL SCIENCE, SPACE AND TECHNOLOGY

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	9.15	8.80	9.45	9.95	11.05
Outlays	8.65	8.90	9.20	9.30	10.15
CBO BASELINE (Preliminary)					
Budget Authority	9.15	8.85	9.25	9.70	10.15
Outlays	8.65	8.95	9.05	9.40	9.85
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-0.05	+0.20	+0.25	+0.90
Outlays	...	-0.05	+0.15	-0.10	+0.30

HIGHLIGHTS

This function includes programs of the National Science Foundation (NSF); the space research and technology programs of the National Aeronautics and Space Administration (NASA); and Department of Energy (DOE) general science programs, which include the conduct and support of basic research in high energy physics and nuclear physics.

Highlights of the major programs in this function are as follows:

- Overall Function--President Reagan's 1987 budget requests $9.45 billion in budget authority and $9.20 billion in outlays. This is $0.65 billion, or about 7.1 percent higher in budget authority than fiscal year 1986 funding. The budget proposes growth for NSF programs (13 percent), DOE general science programs (18 percent), and NASA (4 percent).

- National Science Foundation (NSF)--The President's budget proposes an increase for NSF programs, rising from $1,490 million in fiscal year 1986, to $1,686 million in fiscal year 1987--an overall program level increase of $196 million (or 13 percent.) Within NSF, math and physical sciences programs increase by 14 percent; engineering programs by 19 percent; biological, behavioral and social sciences by 13 percent; and astronomical, atmospheric, earth and ocean science programs by 10 percent. The U.S. Antarctic program increases by six percent. The President's budget also requests $89 million for science and engineering education activities, five percent above the $85 million program level in fiscal year 1986.

- Department of Energy (DOE) General Science Programs--The President's budget proposes an increase in DOE's general science programs from $656 million in fiscal year 1986 to $773 million in fiscal year 1987--an 18 percent increase. This funding is for high energy and nuclear physics programs supported by the DOE.

- National Aeronautics and Space Administration (NASA) Space Programs--The President's budget request does not reflect any recommendations that might be made as a consequence of the destruction of the shuttle Challenger and its crew on January 28, 1986. The President's budget requests an increase for NASA space programs from $6,701 million in fiscal year 1986 to $6,988 million in fiscal year 1987--an increase of 4 percent. The budget includes $410 million for design studies of the space station, following the $196 million spent for this purpose in fiscal year 1986. NASA has estimated that such a station would cost $8 billion over the next decade; other estimates range as high as $20 to $30 billion, depending on the design of the station.

MAJOR ISSUES

1. NASA Space Programs

The NASA budget does not reflect any recommendations that the President might make as a consequence of the destruction of the shuttle Challenger. However, the major issues in this function will involve the Government's reaction to that accident. For example, decisions will have to be made on whether to build another shuttle orbiter, or depend more heavily on expendable launch vehicles to meet the demand for space transportation. Also, the schedule of shuttle launches will have to be reconfigured, and that may have substantial effects on the timing of the funding requirements of many programs. The Government may also have to fund the construction of another Transmission and Data Relay System Satellite (TDRSS) which was part of the Challenger's payload.

The second major set of issues in this function involves whether the U.S. should commit itself to constructing a space station over the next decade, as proposed by the President. Several questions arise: what should be the objectives of such a space station; what should the Nation be willing to pay to accomplish these objectives; and how should the space station be designed in order to maintain flexibility over time, while reducing its costs to the extent feasible? The Reagan budget proposes $410 million to fund additional space station work following the $196 million to be spent for the station in fiscal year 1986.

The President has indicated his interest in promoting private sector investment in space, and that companies making such investments should be able to obtain private sector launch services. One of the issues raised by this is the extent to which services provided by NASA could be spun-off to the private sector, so as to reduce the use of scarce Federal resources. NASA pricing policies for shuttle services are central to this issue, and may be reexamined under the new circumstances.

NASA has been somewhat successful in generating international governmental interest in partly funding the space station; it might also be appropriate to explore whether there are acceptable arrangements that could make it feasible to obtain some private funding for constructing the station.

A further issue involves the question of what should be charged the Department of Defense for the use of NASA shuttle services.

PERSPECTIVE

This function provides most of the Federal funding for the support of basic research in the physical sciences and engineering. However, it provides only about one third of the total Federal funding for basic research. Other large Federal purchasers of basic research are the Department of Defense, the Department of Agriculture, and the National Institutes of Health.

Funding History

Funding for programs in this function have increased from $6.15 billion in fiscal year 1980 to a proposed $9.45 billion level in fiscal year 1987. Of this $3.30 billion proposed increase, $0.70 billion (a 78 percent increase) is for NSF programs, $0.30 billion (a 67 percent increase) for DOE general science programs, and $2.30 billion (a 49 percent increase) is for NASA space programs.

Science and Engineering Education Programs

Science and engineering education programs funded at $77 million in fiscal year 1980 and $71 million in fiscal year 1981, were targeted for elimination by President Reagan in fiscal year 1982 and fiscal year 1983. Congress funded them at $21 million in fiscal year 1982 and $30 million in fiscal year 1983. In fiscal year 1984, the administration requested $39 million and Congress funded them at $75 million. In fiscal year 1987, the President requests $89 million for these programs.

R&D Tax Expenditures

In addition to direct Federal funding of basic research, the U.S. tax code encourages private sector R&D. There is a provision for treating R&D expenditures as current expenses, rather than capital investments, and this is estimated to result in a $2.75 billion revenue loss in fiscal year 1987. Also, there has been a 25 percent tax credit for incremental R&D expenditures enacted in 1981, and this is estimated to result in a fiscal year 1987 revenue loss of $0.40 billion. This tax expenditure expired on December 31, 1985.

FUNCTION 250: GENERAL SCIENCE, SPACE AND TECHNOLOGY

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
NSF Research Programs.....	1.30	1.20	1.30	1.30	1.30	1.30	1.35	1.35	1.30	1.30	1.50	1.45
NSF US Antarctic Program....	0.10	0.05	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
NSF Science and Engineering Education Programs.....	0.10	0.05	0.05	0.05	0.05	0.05	0.05	0.10	0.05	0.10	0.10	0.10
DOE General Science Programs.....	0.70	0.70	0.65	0.70	0.65	0.70	0.70	0.70	0.65	0.65	0.75	0.75
NASA Space Programs.....	6.95	6.60	6.75	6.80	6.70	6.75	7.05	6.85	6.75	6.70	7.00	6.85
Miscellaneous.....	...	0.05	...	...	...	...	...	-0.05	...	...	...	-0.05
TOTAL.....	9.15	8.65	8.85	8.95	8.80	8.90	9.25	9.05	8.85	8.85	9.45	9.20

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 270: ENERGY

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	8.75	5.80	4.35	5.35	4.80
Outlays	5.70	4.45	4.00	4.50	3.95
CBO BASELINE (Preliminary)					
Budget Authority	8.75	-1.25*	5.25	5.15	5.55
Outlays	5.70	4.30	5.35	5.10	4.95
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	+7.05	-0.90	+0.20	-0.75
Outlays	...	+0.15	-1.35	-0.60	-1.00

* This includes a fiscal year 1986 $6.9 billion rescission of funds which were available to the U.S. Synthetic Fuels Corporation.

HIGHLIGHTS

This function contains programs listed under four subfunctions: energy supply; conservation; emergency preparedness; and information, policy and regulation. The function contains funding for solar, fossil, geothermal, nuclear and other energy R&D programs in the Department of Energy (DOE); the uranium enrichment, Naval Petroleum Reserve and National Petroleum Reserve in Alaska programs; the power marketing authorities in DOE, including the Bonneville Power Administration, and the power program of the TVA; the Rural Electrification Administration (REA) in the Department of Agriculture; the nuclear waste program in DOE; the conservation programs in DOE, including the low-income weatherization, schools and hospitals, and state planning grant programs, as well as the Solar Conservation Bank in HUD; the Strategic Petroleum Reserve; and the activities of the Energy Information Administration, the Economic Regulatory Administration, and the Federal Energy Regulatory Commission in DOE; and the Nuclear Regulatory Commission.

Highlights of the major programs in this function are as follows:

- Privatization of the DOE Power Marketing Administrations (PMA's)--President Reagan proposes to sell to the private sector the five DOE PMA's including the Bonneville, Western Area, Southwestern, Southeastern and Alaska Power Marketing Administrations. The President proposes to do this over a period of years, and the budget assumes that the Bonneville and Southwestern PMA's will be sold in 1988, and that the other PMA's will be sold later. The budget anticipates receipts totaling nearly $13.9 billion through fiscal year 1991, but no receipts in fiscal year 1987, from these sales. The receipts are included in Function 950: Undistributed Offsetting Receipts. Pending privatization, the budget also proposes legislation to require that the PMA's repay their debt to the Treasury on a fixed schedule. This will increase Federal receipts, and thus PMA rates, by $162 million in fiscal year 1987.

- Privatization of the Naval Petroleum Reserves (NPR)--President Reagan proposes to sell to the private sector the Naval Petroleum Reserves located in Elk Hills, California and in Teapot Dome, Wyoming. The budget anticipates that $3.6 billion in receipts will accrue from this sale, with $1.2 billion accruing in fiscal year 1987, and the rest in fiscal year 1988. The receipts are included in Function 950: Undistributed Offsetting Receipts.

- Strategic Petroleum Reserve (SPRO)--President Reagan's budget recommends that no oil be acquired for the SPRO in fiscal year 1987, and consequently requests no funds. President Reagan also seeks no further funds for the development of additional storage capacity, while current policy assumes $192 million for this purpose. SPRO will have nearly 500 million barrels in storage at the end of fiscal year 1986. The present legally approved plan is that SPRO should contain 750 million barrels upon completion, and the target fill rate in law is 300,000 barrels a day. However, the fiscal year 1986 Interior Appropriations Act provides $290 million for SPRO oil fill in fiscal year 1986, sufficient to fill the SPRO at only an estimated 30,000 barrel-a-day rate.

- Rural Electrification Administration (REA)--President Reagan proposes to reduce the REA insured electric loan program from $0.65 billion in fiscal year 1986 to $0.375 billion in fiscal year 1987 (a 42 percent reduction); to reduce REA insured telephone loan programs from $0.30 billion in fiscal year 1986 to $60 million in fiscal year 1987 (an 80 percent reduction); and to reduce the REA loan guarantee program from a minimum of $0.975 billion in new commitments during fiscal year 1986 to no more than $0.225 billion in fiscal year 1987 (a reduction of at least 77 percent). President Reagan's budget also proposes legislation to: raise the interest rates on REA's insured loan programs to the cost of Treasury borrowing plus 1-1/8 percent, from the present five percent; assess a fee on existing REA co-op borrowers to recover the cost of any other co-op's loan defaults; and assess a fee on new borrowers to pay for the administrative costs of the REA. Finally, the President proposes to phase out all REA lending programs by 1990.

- DOE Energy Conservation Grant Programs--President Reagan requests $5 million for program direction costs of these programs which were funded at a $257 million level in fiscal year 1986. The Reagan administration assumes that no Federal funding for these programs is required in view of the availability to the States of funds derived from the settlement of several oil overcharge fund cases, such as the Exxon case.

- Energy Conservation R&D--President Reagan's request of $71 million represents a reduction of 58 percent from the $171 million budgeted in fiscal year 1986.

- Solar Energy R&D Programs--President Reagan's request of $73 million represents a reduction of 50 percent from the $145 million budgeted in fiscal year 1986.

- Fossil Energy R&D Programs--President Reagan's request of $83 million represents a reduction of 76 percent from the $343 million budgeted in fiscal year 1986.

- Commercial Nuclear Waste Programs--President Reagan's budget requests $769 million in fiscal year 1987 for a program to dispose of commercial nuclear wastes which is fully financed with user fees on generators of nuclear wastes. This is an increase of 54 percent from the fiscal year 1986 level of $499 million.

- Uranium Enrichment Programs--The President's budget requests $1,051 million which is a 32 percent reduction from the fiscal year 1986 level of $1,551 million. This principally reflects the President's decision to terminate the Gaseous Centrifuge Enrichment Plant (GCEP) in Portsmouth, Ohio.

- Magnetic Fusion R&D Programs--President Reagan's budget requests $333 million in fiscal year 1987 for magnetic fusion R&D programs; this represents a nine percent reduction from the fiscal year 1986 level of $365 million.

- Federal Energy Regulatory Commission (FERC) User Fees--President Reagan's budget assumes that legislation introduced by the administration will be enacted to raise $26 million in receipts to partly offset the costs of running the FERC.

- Nuclear Regulatory Commission User Fees--President Reagan's budget requests legislation to allow the NRC to impose $0.2 billion in annual user fees on operating nuclear power plants, in partial recovery of the costs of running the NRC.

The following table is a listing of major energy program percentage changes over the past six fiscal years.

TABLE 1: MAJOR CHANGES IN ENERGY PROGRAMS[1/]

(In millions of dollars of budget authority)

	Actual FY 1981	Actual FY 1983	Current FY 1986	President Reagan FY 1987	Percentage change 1987/ 1986	Percentage change 1987/ 1981
Solar energy R&D.....	549	202	145	73	-50	-87
Energy conservation R&D....	292	134	171	71	-58	-76
Conservation grants.....	430	384	257	5*	-98*	-99*
Fossil energy R&D.....	997	330	343	83	-76	-92
Electric storage/systems...	112	43	29	16	-45	-86
Geothermal energy R&D.....	156	58	27	18	-33	-88
Strategic Petroleum Reserve Oil Acquisition.....	3,205	2,074	290	0	-100	-100
Uranium Enrichment.....	1,495	1,834	1,551	1,051	-32	-30
Federal Energy Regulatory Commission.....	75	80	95	99	+4	+32
Energy Information.....	90	58	58	60	+3	-33
Rural Electrification Administration (REA) Insured Loans.....	1,100	1,100	947	435	-54	-60
REA Loan Guarantees....	5,145	4,745	975	225	-77	-96
Nuclear Regulatory Commission.....	441	465	400	405	+1	-8

1/ The percentage reductions in the table above do not reflect the effect of inflation on the real program level. If this inflation effect were taken into account, the real reductions would be even greater than displayed, since 1987 dollars are estimated to be worth only 96 percent of their 1986 value, and only 78 percent of their 1981 value.

* The $5 million budget authority request for energy conservation grant programs is solely for program direction costs. The administration assumes that funds will be available to the States for these kinds of programs from final settlements of oil overcharge cases (such as the Exxon case.)

MAJOR ISSUES

1. Privatization of the DOE Power Marketing Administrations (PMA's)--President Reagan proposes to sell to the private sector the five DOE PMA's including the Bonneville, Western Area, Southwestern, Southeastern and Alaska Power Marketing Administrations. The budget anticipates receipts totaling nearly $13.9 billion from these sales through 1991, although no receipts are expected in fiscal year 1987. The price that can be expected from selling a PMA is a function of its profit potential. Thus, the first issue raised is what are the terms and conditions that will be placed on the operators of the PMA's, specifically regarding their pricing policies, and the costs they are required to bear. At present, the PMA's are supposed to operate on a cost recovery basis only, including recovery of capital costs using the Government's cost of money. Their commercial value to a private operator would depend strongly on whether he would be allowed to change the conditions under which a PMA has operated in the past. Therefore, the debate on whether to sell the PMA's is also a debate on the larger question of the terms and conditions under which the PMA's shall operate.

   In addition, there are concerns as to whether this is an appropriate time for selling the PMA's. There is presently an excess of electric power capacity in much of the Nation.

2. Privatization of the Naval Petroleum Reserves (NPR)--The President has proposed to sell to the private sector the Naval Petroleum Reserves in Elk Hills, California, and in Teapot Dome, Wyoming. The Budget anticipates that $3.6 billion in receipts will accrue from this sale, $1.2 billion in fiscal year 1987, and the rest in fiscal year 1988. The first issue raised by this proposal is whether this is an appropriate time for selling these oil and gas reserves, in light of present world oil market developments.

   Another issue concerns what is to be gained from selling those Reserves. At the present time, the Reserves are being produced at their maximum efficient rate and it is not clear how that would change as a consequence of selling the Reserves. That is, what would private owners of the Reserve do that the Government is not now doing? If there are no management changes to be expected, the sale of the NPR would simply exchange one asset for another: a future government revenue stream derived from the sale of oil and gas produced from the NPR, in exchange for a lump sum payment.

3. What is an Appropriate Governmental Role in Energy R&D Programs?

President Reagan again recommends major reductions in energy programs and proposes instead that the U.S. rely almost solely on market forces where energy issues are concerned. At the present time world oil market prices are falling, because supply exceeds demand. This situation may persist for some time, but lower oil prices eventually will stimulate demand, discourage supply, and lead to tighter world oil markets. Experience has shown that the world oil market is extremely insecure, and that it can be upset by deliberate manipulation, or by political upheavals beyond anyone's control. The U.S. may have a national security concern with the uncertainty of tne world oil market which is not adequately reflected in the market price of imported oil. If so, this may justify a strong Federal role in supporting energy R&D programs, and raises the following issues in the President's budget:

- A reduction of solar energy R&D programs by 50 percent of their fiscal year 1986 level.
- A reduction of fossil energy R&D programs by 76 percent of their fiscal year 1986 level.
- Reductions of this scale in these, and other programs such as geothermal, conservation and nuclear R&D.

4. Strategic Petroleum Reserve (SPRO)

At issue is whether the Federal Government should stop filling the SPRO when it reaches 500 million barrels in storage, as the President now seeks, or whether the Government should take steps to continue filling the Reserve at the 30,000 barrel a day rate that was agreed to in the fiscal year 1986 Interior Appropriations Act. Another issue is whether the Government should continue to develop storage capacity for possible future use. A final issue is whether surplus food commodities held by the Commodity Credit Corporation should be exchanged for oil supplies to be stored in the SPRO as Congress recently authorized.

5. Rural Electrification Administration (REA) Programs

At issue is whether combined Rural Electrification Administration programs should be cut by 66 percent from the fiscal year 1986 level, and whether the electric insured loan program should be reduced by 42 percent, or the telephone insured loan program by 80 percent. Another issue is whether the interest rate on REA's insured loan programs should be raised to the Treasury cost of borrowing plus one and one eighth percent (a little less than 11 percent for long term bonds) from the present level of five percent. A final issue concerns whether a user fee should be assessed on REA co-op borrowers to recover the cost of program loan defaults.

FUNCTION 15

(In t

Program	FY 1985 Actual		Fisca CBO Baseline (Preliminary)	
	BA	O	BA	O
Foreign Economic and Financial Assistance.....	6.50	5.40	4.65	4.
Security Assistance.....	13.75	9.40	10.55	9.
Conduct of Foreign Affairs	2.50	2.05	2.30	2.
Information and Exchange Activities.....	0.95	0.80	0.95	0
Export-Import Bank Direct Loans.....	0.65	-0.40	1.05	-0
Fair Export Financing.....	...	...	...	
Foreign Military Sales Trust Fund(NET).....	2.85	0.15	0.50	0
Offsetting Receipts and Other.....	-0.75	-1.20	-0.80	-0
TOTAL.....	26.45	16.20	19.20	1

0: INTERNATIONAL AFFAIRS

illions of dollars)

l Year 1986			Fiscal Year 1987					
	President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O
90	4.65	4.90	5.05	4.70	4.50	4.80	4.90	5.00
30	10.25	9.70	10.40	8.25	10.00	8.00	11.25	10.95
30	3.00	2.35	2.35	2.35	2.30	2.30	3.85	3.05
90	0.95	0.95	0.95	0.95	0.95	0.90	1.15	1.05
15	...	-0.15	1.10	-1.10	1.05	-1.10	..	-1.00
...	...	...	...	...	...	...	0.30	...
20	2.00	-0.30	1.00	...	1.00	...	1.30	- 20
35	-0.05	-0.30	-1.00	-0.25	-1.05	-0.25	-0.10	-0.25
10	20.80	17.15	19.85	14.90	18.75	14.65	22.65	18.60

PERSPECTIVES

Solar Energy R&D

The reductions proposed by President Reagan for energy programs in fiscal year 1987 are from a fiscal year 1986 base which has already been reduced significantly over the last five years. In fiscal year 1981, for example, solar energy R&D programs were funded at $549 million and are being proposed for fiscal year 1987 at the $73 million level; this represents an 87 percent reduction from the fiscal year 1981 level. The real reduction is even greater since fiscal year 1987 dollars are estimated to be worth only 78 percent of their fiscal year 1981 value.

Energy Conservation Programs

Energy conservation R&D programs proposed for fiscal year 1987 at the $71 million level, were funded at $292 million in fiscal year 1981. This represents a 76 percent reduction from the fiscal year 1981 level. Energy conservation grant programs, such as the low-income weatherization, school and hospital, and state energy planning grant programs are proposed to be funded at $5 million in fiscal year 1987, rather than the fiscal year 1981 level of $430 million. This represents a 99 percent reduction from the fiscal year 1981 level.

Fossil Energy R&D

Fossil energy R&D programs proposed at $83 million in fiscal year 1987, were funded at $350 million in fiscal year 1984, and $997 million in fiscal year 1981. This represents a 92 percent reduction from the fiscal year 1981 level.

Strategic Petroleum Reserve

President Reagan proposes to shut down the Strategic Petroleum Reserve in fiscal year 1987 with the Reserve holding approximately 500 million barrels, which is two-thirds of its present legal target of 750 million barrels. In fiscal year 1986, Congress appropriated funds sufficient to fill the Reserve at no less than a 30,000 barrel a day rate, which is approximately one-tenth the rate prescribed as a target in the Energy Emergency Preparedness Act (PL 97-229). In calendar 1981, SPRO was filled at a rate of approximately 336,000 barrels a day. The President also proposes to terminate any construction of additional storage facilities.

FUNCTION 270: ENERGY

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Energy Supply	5.50	2.60	-2.45*	2.40	4.55	2.75	3.90	3.65	3.70	3.55	3.65	2.85
Energy Conservation	0.45	0.50	0.45	0.50	0.45	0.45	0.45	0.50	0.45	0.50	0.05	0.25
Strategic Petroleum Reserve (SPRO)	2.05	1.85	0.10	0.65	0.10	0.50	0.20	0.55	0.20	0.55	...	0.25
Information, Policy and Regulation	0.70	0.75	0.65	0.70	0.65	0.70	0.70	0.70	0.65	0.70	0.65	0.65
Miscellaneous	0.05	...	...	0.05	0.05	0.05	...	-0.05	...	...	...	...
TOTAL	8.75	5.70	-1.25*	4.30	5.80	4.45	5.25	5.35	5.00	5.30	4.35	4.00

* Includes a fiscal year 1986 $6.9 billion rescission in funds which were available to the U.S. Synthetic Fuels Corporation.

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 300: NATURAL RESOURCES AND ENVIRONMENT

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	13.35	11.95	10.95	10.60	10.00
Outlays	13.35	12.90	11.95	11.80	11.65
CBO BASELINE (Preliminary)					
Budget Authority	13.35	12.55	12.95	13.35	13.75
Outlays	13.35	12.80	13.10	14.10	13.95
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-0.60	-2.00	-2.75	-3.75
Outlays	...	+0.10	-1.15	-2.30	-2.30

HIGHLIGHTS

This function contains a wide variety of agencies and programs with primary missions focused on prudent management and protection of natural resources and public health by assuring a clean environment. Agencies with major programs in this function include the Corps of Engineers, Bureau of Reclamation, Forest Service, Bureau of Land Management, Fish and Wildlife Service, Environmental Protection Agency, National Oceanic and Atmospheric Administration and the Geological Survey. The President's 1987 budget proposes a decrease in this function of $2.00 billion in budget authority and $1.15 billion in outlays from the preliminary CBO baseline. This represents a 13 percent decrease in budget authority from the current fiscal year 1986 level.

Highlights of the major programs in this function are as follows:

- Water Resources -- The President's 1987 budget provides $3.30 billion in funding for Corps of Engineers programs which is partially offset by $0.20 billion in new user fees for inland waterways and deep draft navigation. This means a total Corps program level of $3.50 billion compared with the 1986 preliminary CBO baseline level of $2.70 billion and the 1987 preliminary CBO baseline level of $2.80 billion. The President's budget assumes 19 new starts for inland waterways and deep draft harbor projects with enhanced cost sharing by local sponsors partially offsetting the cost.

  The budget also proposes $0.95 billion for Bureau of Reclamation activities which is $0.25 billion above the 1986 current level and $0.25 billion above the 1987 preliminary CBO baseline level.

  Finally, the budget proposes termination of the Soil Conservation Service (SCS) watershed activities. For 1987, the budget proposes $84 million for these activities, compared to the current 1986 estimate of $243 million, and the 1987 preliminary CBO baseline of $252 million.

- Conservation and Land Management -- The President's 1987 budget proposes $0.45 billion for conservation and land management programs. This amount compares to the 1986 preliminary CBO baseline of $1.15 billion and the 1987 preliminary CBO baseline of $1.10 billion. The reduction from the 1987 preliminary CBO baseline is primarily attributable to reductions of $0.25 billion for the Forest Service, $0.10 for the Bureau of Land Management, and $0.30 billion for agricultural conservation programs.

- Recreational Resources -- The President's 1987 budget provides $1.15 billion for recreational resource programs compared to funding of $1.45 billion in 1986 and a preliminary CBO baseline of $1.50 billion in 1987. The budget's $0.30 billion decrease from 1986 is attributed to a nearly 82 percent reduction in land acquisition, termination of urban parks and historic preservation funds and an increase in recreation user fees of $0.50 billion.

- Pollution Control and Abatement -- The President's 1987 budget proposes $4.10 billion for pollution control and abatement. The 1986 preliminary CBO baseline level is $4.60 billion and the 1987 preliminary CBO baseline level is $4.80 billion for these programs.

  - The President's budget assumes a decrease from 1986 of $0.05 billion in EPA operations, to a level of $1.30 billion.

  - The budget proposes $1.80 billion for the wastewater construction grants program, $574 million less than the amount provided in 1986. The budget assumes a phase-out of construction grants by 1990 and that future grants be limited to projects already underway.

  - The budget also assumes enactment of legislation to reauthorize the superfund program. The budget proposes a 1987 funding level of $1,050 million compared to the 1986 preliminary CBO baseline level of $861 million. The budget however, states that the request will be modified if necessary after the program is reauthorized by the Congress.

- Other Natural Resources -- The President's 1987 budget proposes $1.55 billion for other natural resource activities. This amount compares to the 1986 preliminary CBO baseline level of $1.75 billion and the 1987 preliminary CBO baseline level of $1.80 billion. The major budget change from 1986 is a reduction of $0.15 billion in funding for the National Oceanic and Atmospheric Administration operations, research and facilities program. Smaller reductions are also proposed for the Geological Survey and the Bureau of Mines. The budget further proposes a $10 minimum marine recreational sport fishing license to partially offset the costs of managing this exhaustible resources. Coastal States would retain one-half of the license fee.

MAJOR ISSUES

1. Water Resources

Although the President's proposals for the Corps of Engineers are generally consistent with the omnibus legislation currently being considered by the Congress (H.R. 6, S. 1567), there are unresolved issues related to the number of new projects starts, the extent of cost-sharing between the Federal Government and local sponsors, and the level of project cost recovered through user fees.

2. Conservation and Land Management

The budget assumes termination of the ASCS conservation activities. This proposal has been made by the President in previous budgets as well as by several past administrations and rejected each time by Congress.

3. Recreational Resources

The budget assumes virtual elimination of land acquisition by the Forest Service, Bureau of Reclamation, Fish and Wildlife Service and the Bureau of Land Management. The 1986 preliminary CBO baseline level for this activity is $189 million compared to funding of nearly $550 million in 1980. The administration has requested elimination of the land acquisition programs previously and Congress has consistently rejected the proposals. In addition, the budget again proposes an increase in existing recreation user fees. This proposal has been made in the past, but has not been accepted by the Congress.

4. EPA Construction Grants

The proposal to phase out the EPA wastewater treatment construction grant program by 1990 will be an issue. Although there is some legislative history that Congress originally intended this program to be used only to fulfill backlog needs, the House and Senate have passed new multi-year authorizations through 1994 (H.R. 8, S. 1128) that significantly increases the future federal commitment. Such action implies Congressional opposition to a phase out of federal funding for this program.

5. Superfund

The budget assumes reauthorization of the superfund program which expired at the end of fiscal year 1985. The administration has opposed many of the provisions contained in the reauthorization legislation currently being considered by the Congress (H.R. 2005). The program has exhausted most its available funds and shutdown plans are in place.

PERSPECTIVES

The Environmental Protection Agency has experienced a significant growth in the statutory missions since EPA was created. Yet the 1987 budget would provide the same purchasing power for operations it had in the early 1973's. In the early years, EPA was required to control only "conventional" pollutants such as sulfur and suspended solids. Since then, Congress has enacted seven laws which require EPA to control toxics, in addition to conventional pollution. These new responsibilities have roughly doubled EPA's workload and resource needs. A key policy issue is whether the agency can still perform adequately given its increased workload and decreased resources. The General Accounting Office reports noncompliance with basic environmental standards by 82 percent of major sources of water pollution and 78 percent of the highest priority active hazardous waste facilities.

FUNCTION 300: NATURAL RESOURCES AND ENVIRONMENT

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Water Resources												
Corps of Engineers	2.95	3.50	2.70	2.70	2.80	2.95	2.80	2.70	2.70	2.20	3.30	3.25
Bureau of Reclamation	1.20	1.00	0.70	0.85	0.80	1.00	0.70	0.70	0.70	0.70	0.95	1.00
SCS	0.20	0.25	0.25	0.25	0.20	0.25	0.25	0.25	0.25	0.25	0.20	0.20
Other	-0.25	-0.65	-0.05	...	-0.25	-0.20	0.05	0.05	-0.05	0.45	-0.75	-0.60
Subtotal	4.10	4.10	3.60	3.80	3.55	4.00	3.70	3.70	3.60	3.60	3.70	3.85
Conservation and Land Management												
Forest Service	1.85	1.95	1.90	1.95	1.90	1.95	1.85	1.85	1.90	1.90	1.65	1.65
BLM	0.55	0.55	0.45	0.45	0.45	0.45	0.55	0.55	0.45	0.50	0.45	0.45
Surface Mining	0.40	0.25	0.20	0.30	0.30	0.30	0.30	0.35	0.20	0.30	0.30	0.35
SCS	0.40	0.40	0.40	0.60	0.40	0.40	0.40	0.40	0.40	0.40	0.35	0.40
ASCS	0.20	0.20	0.20	0.25	0.05	0.20	0.20	0.20	0.20	0.20	...	0.05
Timber	-0.70	-0.70	-0.75	-0.75	-0.85	-0.85	-0.80	-0.80	-0.80	-0.80	-0.85	-0.85
Other and Receipts	-1.25	-1.60	-1.25	1.50	-1.45	-1.40	-1.40	-1.45	-1.05	-1.30	-1.45	-1.45
Subtotal	1.45	1.50	1.15	1.30	0.80	1.05	1.10	1.10	1.30	1.20	0.45	0.60

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Recreational Resources												
Land Acquisition	0.35	0.40	0.20	0.25	0.15	0.30	0.20	0.25	0.20	0.25	0.05	0.20
FwS Management	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.25
Operations of NPS	0.65	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.65	0.65
Other and Receipts	0.25	0.35	0.40	0.20	0.35	0.35	0.45	0.35	0.40	0.35	0.15	0.25
Subtotal	1.55	1.60	1.45	1.45	1.40	1.55	1.50	1.50	1.45	1.50	1.15	1.35
Pollution												
EPA Operations	1.30	1.20	1.35	1.30	1.35	1.30	1.45	1.35	1.35	1.30	1.30	1.35
Superfund	0.60	0.35	0.85	0.40	0.85	0.45	0.90	0.75	0.85	0.60	1.05	0.75
Construction Grants	2.40	2.90	2.35	2.80	2.35	2.80	2.50	2.75	2.35	2.75	1.80	2.30
Other and Receipts	...	...	0.05	*	0.05	0.05	0.05	*	0.05	...	-0.05	0.05
Subtotal	4.30	4.45	4.60	4.50	4.60	4.60	4.80	4.85	4.60	4.55	4.10	4.45
Other Natural Resources												
NOAA Operations	1.25	1.00	1.10	1.15	1.05	1.10	1.15	1.25	1.10	1.25	0.90	1.10
Geological Survey	0.40	0.45	0.40	0.40	0.40	0.40	0.40	0.45	0.40	0.40	0.40	0.40
Other and Receipts	0.30	0.25	0.20	0.25	0.25	0.25	0.25	0.25	0.20	0.25	0.20	0.20
Subtotal	1.95	1.65	1.75	1.80	1.70	1.75	1.80	1.95	1.75	1.90	1.50	1.70
FUNCTION TOTAL	13.35	13.35	12.55	12.80	11.95	12.90	12.95	13.10	12.55	12.90	10.95	11.95

*Less than $25 million.

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 350: AGRICULTURE

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	27.50	28.05	19.60	22.25	22.55
Outlays	25.55	25.85	19.55	19.65	18.90
CBO BASELINE (Preliminary)					
Budget Authority	27.50	30.60	19.85	24.40	24.40
Outlays	25.55	30.80	19.80	23.20	23.05
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-2.55	-0.25	-2.15	-1.85
Outlays	...	-4.95	-0.25	-3.55	-4.15

HIGHLIGHTS

This function includes programs and activities designed to insure that a plentiful, high quality supply of food and fiber is available in the United States. All of the programs in this function are in the Department of Agriculture (USDA). The two largest programs in the function, the price support program of the Commodity Credit Corporation (CCC) and farm loans from the Agricultural Credit Insurance Fund (ACIF), seek to achieve the overall function objective by protecting farm income from extreme price fluctuations and natural disasters. Other programs assist agriculture by providing for the orderly marketing of high quality commodities; conducting research on plant and animal varieties; preventing the spread of plant and animal pests and diseases; disseminating knowledge to improve farm techniques and increase crop yields; and promoting exports of U.S. farm commodities. The agencies in the USDA conducting these activities include the Agricultural Research Service, the Extension Service, the Animal and Plant Health Inspection Service (APHIS), the Agricultural Marketing Service, and the Foreign Agricultural Service.

President Reagan's 1987 budget proposes amounts for 1987 that are $0.25 billion, or 1 percent, below the preliminary CBO baseline estimate for budget authority and $0.25 billion, or 1 percent, below the preliminary CBO baseline estimate for outlays.

Highlights of the major programs in this function are:

- Commodity Price Support Programs - President Reagan's 1987 budget reflects an estimated $4.00 billion decline in outlays for CCC price support programs from $20.35 billion in 1986 to $16.35 billion in 1987. This results from the Food Security Act of 1985 (the 1985 farm bill) which provided for a gradual decrease in crop loan rates and target prices and for advance deficiency payments, which has the effect of moving outlays from 1987 into 1986. Further spending reductions will occur because of the March 1, 1986 sequestration of funds. This spending decline is estimated to occur without any change in existing law. The CBO preliminary baseline estimates a larger decline of $10.30 billion from $25.00 billion in 1986, down to $14.70 billion in 1987 as a result of the same 1985 farm bill provisions and sequestration reductions.

- Commodity Export Assistance - The budget includes a legislative proposal to reduce short-term export credit guarantees in 1987, from $5.0 billion, as mandated by the 1985 farm bill, down to $3.0 billion, a reduction of 40 percent. In addition, the budget also proposes legislation to terminate the intermediate export credit guarantee program (3 to 10 year loans), which is set at $500 million in 1987 by the 1985 farm bill. In addition, the administration proposes to increase guarantee fees for short-term export guarantees from less than 1 percent to 5 percent. This will reduce crop price support spending by $140 million in 1987 and by $826 million over three years, 1987-1989.

- Farm Loans - The budget proposes $1.50 billion in new direct farm operation and ownership loans and $2.50 billion of new loan guarantees in 1987. These are the same levels as authorized in the 1985 farm bill. The budget also projects the same gradual shift from direct farm loans to guaranteed loans in future years as contained in the 1985 farm bill. The Reagan budget does propose a new 1 percent origination fee for new direct farm loans, which would reduce net farm loan spending by $14 million in 1987.

- Federal Crop Insurance Corporation (FCIC) - The budget again proposes a 5-year phase-out of the Federal administration of and subsidies for crop insurance. By 1991, the crop insurance program would be fully self-supporting. The administration estimates this proposal would reduce Federal outlays by $338 million in 1987 and $1.35 billion over 3 years, 1987-1989. The current outlay estimate for FCIC accounts in 1986 is $557 million, and the preliminary CBO baseline estimate for 1987 is $550 million. In addition, the Reagan budget proposes a new user fee to recover the direct Federal administrative costs of the crop insurance program. This fee will yield an estimated $21 million in 1987.

- USDA Extension Service - The 1987 budget proposes an appropriation of $140 million for the USDA Extension Service. This is a reduction of $188 million, or 57 percent, below the 1986 appropriation of $328 million. The preliminary 1987 CBO baseline estimate for the Extension Service is $341 million. The Extension Service would focus on the dissemination of information flowing from basic agriculture research. Larger State, local and private contributions would be required to maintain other Extension Service programs at 1986 levels.

- User Fees - The 1987 Reagan budget again proposes new user fees or increases in existing user fees for several USDA services. Included among the fee increases are 1) grain inspections, 2) Marketing Service market news, 3) packer and stockyard inspections, and 4) APHIS veterinary and lab services. The administration estimates these user fee proposals will increase USDA offsetting receipts by $69 million in 1987.

MAJOR ISSUES

1. Federal Crop Insurance

The Reagan budget again proposes to "privatize" or phase-out Federal crop insurance, which covers crop losses from natural disasters, over the next five years, 1987-1991. Over that period, both the Federal subsidy for the basic premium, an estimated 25 percent, as well as Federal support for the operating costs of agent-sellers and reinsurers will be phased out. In addition, the administration proposes a new user fee to recover the direct Federal costs of overseeing the program, estimated at $21 million in 1987. The Reagan administration believes that the private insurance industry can operate crop insurance on its own and that the Federal subsidy distorts the true cost of agricultural production and the return on land investment and encourages the farming of marginal lands.

2. Commodity Export Assistance

The Reagan budget includes a legislative proposal to reduce short-term (less than three-year loans) export credit guarantees in 1987 from $5.0 billion, as mandated by the 1985 farm bill, down to $3.0 billion. In addition, the budget contains a legislative proposal to terminate intermediate (3 to 10-year loans) export credit guarantees. The 1985 farm bill mandated $500 million of these intermediate term guarantees in 1987 because of a failure of the administration to utilize discretionary authority for such guarantees in the past. The administration believes that reliance on free-market export financing coupled with the reduced loan rates in commodity price support programs will result in an expanded volume of commodity export activity in 1987 and future years.

PERSPECTIVES

Federal spending for agricultural assistance can be subject to wide estimating uncertainty. Unusual weather, natural disasters, or sudden changes in foreign demand can shift commodity prices and/or harvest yields dramatically. These changes, in turn, affect the number of farmers who choose to participate in price support programs, the amount of crops placed under CCC loans, and the amount of deficiency payments farmers are eligible for under existing formulas. This uncertainty is illustrated by recent commodity program spending patterns. After staying in a range of $2 to $4 billion per year for a long time, net outlays for price support loans and payments expanded dramatically from $4.0 billion in 1981 to a record $18.8 billion in 1983. This record spending was caused by a decline in U.S. farm exports resulting from the high value of the dollar and the worldwide recession of 1981-1982, which reduced the effective demand for U.S. grown commodities. This in turn led to a buildup of large surpluses and

record CCC loans for those surpluses. Net outlays for CCC price support activity fell to $7.3 billion in 1984 in response to the payment-in-kind (PIK) program put in place by the Reagan administration in 1983. The PIK program gave farmers surplus CCC commodities in return for reducing production. This led to a significant decrease in the amount of crops placed under CCC loans in 1984. Net spending for commodity programs increased to $17.7 billion in 1985 after completion of the PIK program.

The Food Security Act of 1985, enacted in December, 1985, provides for a significant shift in the focus of Federal agriculture policy. The major features of this 1985 farm bill include:

- A gradual decline in crop loan rates and increases in acreage setasides to help make American commodities more competitive on world markets.
- Freezing target prices in 1986 and 1987 to help protect farm income, with gradual declines starting in 1988.
- A requirement for advance deficiency payments in 1986 and discretionary authority for advance payments in 1987 and future years to assist in crop production financing.
- Major commodity export assistance to combat unfair foreign trade practices and to ease the transition to a more competitive world trade for agricultural goods.
- A new conservation reserve program and strengthened sodbuster provisions to protect marginal land from overproduction.
- A dairy diversion program and authority for dairy herd buyouts to help reduce the surplus of milk products.

The preliminary CBO baseline estimates that these commodity program changes will result in $25.0 billion of CCC spending in 1986, but a sharp decline to $14.7 billion in 1987.

FUNCTION 350: AGRICULTURE

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Subfunction 351, Farm Income Stabilization:												
Commodity Price Support Programs (CCC).....	15.20	17.70	25.00	25.00	21.65	20.35	14.70	14.70	14.70	14.70	15.50	16.20
Farm Operation and Ownership Loans (ACIF).....	9.80	5.45	3.40	3.30	4.20	3.05	2.80	2.60	2.80	2.60	2.30	1.50
Federal Crop Insurance.....	0.45	0.50	0.35	0.55	0.35	0.55	0.35	0.55	0.35	0.55	0.25	0.25
All Other.....	0.10	0.10	0.05	0.10	0.05	0.05	0.05	0.05	0.05	0.05	*	*
Subtotal, Subfunction 351	(25.55)	(23.75)	(28.75)	(28.95)	(26.25)	(24.00)	(17.95)	(17.90)	(17.95)	(17.90)	(18.05)	(17.95)
Subfunction 352, Agricultural Research and Services:												
Extension Service.....	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.15	0.20
Agricultural Research Service	0.50	0.50	0.50	0.45	0.50	0.45	0.50	0.50	0.50	0.50	0.50	0.50
Cooperative State Research.	0.30	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.25	0.25	0.25
Animal and Plant Health Inspection Service (APHIS)	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.25	0.25
All Other.....	0.45	0.40	0.45	0.45	0.40	0.40	0.45	0.45	0.45	0.45	0.40	0.40
Subtotal, Subfunction 352	(1.90)	(1.80)	(1.85)	(1.85)	(1.85)	(1.85)	(1.90)	(1.90)	(1.90)	(1.85)	(1.55)	(1.60)
TOTAL.....	27.50	25.55	30.60	30.80	28.05	25.85	19.85	19.80	19.85	19.75	19.60	19.55

*Less than $25 million.

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 370: COMMERCE AND HOUSING CREDIT

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	12.10	8.75	10.20	8.70	6.50
Outlays	4.25	3.80	1.35	3.85	-0.50
CBO BASELINE (Preliminary)					
Budget Authority	12.10	10.20	10.65	11.25	8.35
Outlays	4.25	4.35	4.90	6.00	4.00
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-1.45	-0.45	-2.55	-1.85
Outlays	...	-0.55	-3.55	-2.15	-4.50

HIGHLIGHTS

This function includes the major Federal programs intended to assist business and commerce and to enhance the financing of housing construction. The function also includes the Postal Service, and funding for the Census Bureau and for various regulatory agencies. The major agencies included in this function are the Federal Housing Administration (FHA), the Government National Mortgage Association (GNMA) operating through the Department of Housing and Urban Development Administration, the Farmers Home Administration (FmHA) within the Department of Agriculture, the Small Business Administration (SBA), the Census Bureau and other parts of the Commerce Department.

The 1987 budget proposals for this function would continue and extend the themes that have been proposed since 1980. Specifically, the budget would substantially reduce the activities in this function by the proposed termination or reduction of several major programs. These proposals are based on the philosophy that the business and housing sectors are best assisted by an improved national economy and continued economic growth.

In the housing sector, the budget proposes restricting FHA mortgage insurance and termination of the rural housing program. In addition, the budget proposes the termination of the Section 202 elderly and handicapped program. The budget also continues to support the position that the two housing-related, Government-sponsored enterprises -- the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) --should be completely "privatized". The budget again proposes the institution of new fees on FNMA and FHLMC which would increase receipts for the Federal government. This proposal is consistent with other broad proposals for new or increased fees in various credit areas including FHA and VA housing loans.

In the business sector, the budget proposes the elimination of the Small Business Administration and the sale of existing SBA loan assets. The SBA programs are viewed by the Administration as unsuccessful and inefficient.

Finally, the budget proposes the elimination of the Revenue foregone subsidy to the Postal Service.

Highlights of the major programs in this function are:

- Rural Housing Loans - The budget proposes termination of the Farmers Home rural housing program and transferring some of the functions to the Department of Housing and Urban Development (HUD). Under the proposal, HUD would expand its role in rural areas and assume full responsibility for these housing assistance needs by allocating 50,000 newly proposed voucher units evenly between urban and rural areas. Therefore, the budget proposes no new loan commitments in fiscal year 1987.

- Postal Service - The budget again proposes the termination of the revenue foregone subsidy which reduces postage rates for various classes of nonprofit users. The proposed fiscal year 1987 budget authority level for the Postal Service would be $3.50 billion compared to the fiscal year 1986 level of $3.25 billion and a fiscal year 1987 preliminary CBO baseline level of $3.10 billion.

- Section 202 Housing for the Elderly or Handicapped - The budget proposes the termination of the Section 202 program which provides direct loans to nonprofit organizations which construct housing for lower income elderly and handicapped. The budget proposes no new budget authority for fiscal year 1987 compared to a fiscal year 1986 preliminary CBO baseline level of $584 million and a fiscal year 1987 preliminary CBO baseline level of $610 million.

- Small Business Administration - The budget again proposes the termination of the SBA credit programs and the sale of loan assets to the public. The non-credit programs of SBA would be transferred to the Commerce Department. The 1986 level for the Business Loan Investment Fund (BLIF) is $162 million in budget authority and the 1987 preliminary CBO baseline level is $610 million.

- Mortgage Backed Securities - The budget proposes a fee on borrowings and on mortgage-backed security issues of the Federal Home Loan Mortgage Corporation (FHLMC), the Federal National Mortgage Association (FNMA), and the Government National Mortgage Association (GNMA). This proposal is consistent with the administration's philosophy that these government-sponsored enterprises should be privatized.

- Mortgage Guarantee Limitations - The budget proposes for fiscal year 1987, a continuation of the fiscal year 1986 (pre-sequestration) new commitment limitation of $68.3 billion on GNMA securities which are backed by pools of mortgages that are either insured by the FHA or the VA.

- FHA Mortgage Insurance - The budget proposes maintaining at $50.9 billion the limitation on FHA guaranteed loan commitments, the level since 1983. The budget also proposes to target FHA mortgage assistance to families with incomes below $40,000 and discontinue making loans to investors and individuals purchasing a second home.

MAJOR ISSUES

1. Rural Housing Loans

The 1987 budget would terminate the FmHA rural housing program funded at $3.45 billion in 1986. The preliminary CBO baseline is $3.50 billion. A new HUD assisted housing program would then split the funding evenly between urban areas and rural areas. The Farmers Home Administration operates the rural housing program which is targeted to very low and low-income households to finance owner occupied and rental housing. The administration has tried to change and reduce this program in the past and now is proposing to combine it with the existing HUD assisted housing program with no related funding. The HUD assisted housing program is discussed in Function 600, Income Security.

2. Postal Subsidy

The Federal revenue foregone subsidy which goes to rural newspapers, classroom publications, charitable organizations, the blind and handicapped and other bulk mailers would be eliminated. In 1986, this program was funded at $716 million; the preliminary CBO baseline for 1987 is $741 million. The administration has proposed substantial reductions in the postal subsidy each year. The current proposal assumes enactment of legislation which would "enable the Postal Service itself to continue the subsidy for most existing subsidized mailers". The assumption is that the Postal Service would have to raise additional revenues through postal rate increases.

3. Section 202 Housing for the Elderly or Handicapped Direct Loans

The budget proposes the termination of Section 202 program, funded at $584 million in 1986. The preliminary CBO baseline for 1987 is $610 million. This proposal differs from the proposal offered in the President's 1986 budget which called for a two-year moratorium and then continue the program in 1988 at a reduced level of units per year. That proposal was not accepted by the Congress.

4. Small Business Administration

The budget proposes the elimination of the credit programs of the Small Business Administration funded at $0.65 billion in 1986 and the transfer of many remaining SBA programs to the Department of Commerce. New direct loan obligation authority of $491 million is requested to cover loan defaults, but the Business and Investment Loan Fund program which guarantees small business loans up to $500,000 would be terminated along with the direct loan program. The proposal would also sell off the loan assets of SBA, which because of their low interest rates would have to be sold at a deep discount. The proposal is based on the belief that small businesses will better benefit from the President's effort to reduce the Federal budget and credit programs and that greater reliance should be put on the private sector.

5. GNMA and Other mortgage related user fees

The President's budget proposes an increase in the guarantee fee that GNMA charges mortgage-backed securities issuers from the current level of 6 to 15 basis points in 1987. Similar fees are also proposed for the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA). The budget also proposes an increase from 3.8 to 5.0 percent for the loan origination fee collected by the Federal Housing Administration for its single-family insurance. Under the proposal, the loan origination fee for VA loans, discussed in Function 700, Veterans, would be increased from one percent to 3.8 percent by 1990.

PERSPECTIVES

The budget includes two themes which are consistent with the themes of the budgets proposed since 1980: First, that the current beneficiaries of the programs in this function would be better served by an overall reduction in Federal spending requiring the termination or suspension of various programs rather than the continued funding of these programs. Secondly, the administration believes that for many of the activities financed in this function, there is a greater role for the private sector to play, particularly in the mortgage credit area and assistance to small businesses.

FUNCTION 370: COMMERCE AND HOUSING CREDIT

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Subfunction 371:												
Rural Housing Insurance Fund	6.20	3.95	3.45	3.70	2.65	3.30	3.50	3.55	3.45	3.50	2.85	1.65
Section 202 Housing for the Elderly Loans	0.50	0.50	0.60	0.55	...	0.50	0.60	0.65	0.60	0.65	...	0.40
FHA Fund	0.15	-0.65	0.20	-1.05	0.10	-1.45	0.25	-1.05	0.20	-1.05	0.10	-1.90
GNMA	...	-0.80	...	-0.30	...	-0.75	...	-0.35	...	-0.35	...	-0.75
Federal Deposit Insurance Corporation	...	-1.95	...	-1.80	...	-1.65	...	-2.00	...	-2.00	...	-1.90
Federal Savings and Loan Insurance Corporation	0.20	0.60	...	0.60	...	0.45	...	0.30	...	0.30	...	-0.20
All Other	0.05	-0.75	...	-0.75	0.05	-0.20	...	-0.75	...	-0.80	...	-0.35
Subtotal, Subfunction 371	7.10	0.90	4.25	0.95	2.80	0.20	4.35	0.35	4.25	0.30	2.95	-3.05
Subfunction 372:												
Postal Service	1.45	0.15	3.25	0.60	3.25	0.65	3.10	1.45	3.10	1.45	3.45	2.65
Revenue Foregone	1.20	1.20	0.70	0.70	0.70	0.70	0.75	0.75	0.70	0.70	0.05	0.05
Subfunction 376:												
Small Business Loans	0.50	0.25	0.15	0.30	0.15	0.40	0.35	0.35	0.35	0.35	2.50	2.60

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Small Business Salaries and Expenses.....	0.20	0.25	0.20	0.30	0.20	0.30	0.20	0.30	0.20	0.30	0.20	0.25
All Other.....	1.70	1.50	1.60	1.45	1.60	1.60	1.85	1.75	1.40	1.50	1.05	-1.10
Subtotal, Subfunction 376	2.40	2.00	1.95	2.05	1.95	2.30	2.40	2.40	1.95	2.15	3.75	1.75
TOTAL.....	12.10	4.25	10.20	4.35	8.75	3.80	10.65	4.90	10.00	4.60	10.20	1.35

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 400: TRANSPORTATION

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	29.55	27.55	22.55	22.40	22.50
Outlays	25.85	27.10	25.50	24.10	23.40
CBO BASELINE (Preliminary)					
Budget Authority	29.55	28.00	29.05	29.65	30.50
Outlays	25.85	27.45	27.60	27.40	27.95
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-0.45	-6.50	-7.25	-8.00
Outlays	...	-0.35	-2.10	-3.30	-4.55

HIGHLIGHTS

This function includes highways, mass transit, rail, air, water, and general transportation safety and regulation programs. The budget for fiscal year 1987 provides a $5.5 billion or over 20 percent decrease in budget authority and nearly a 7 percent decrease in outlays from the 1986 CBO preliminary current policy baseline. Almost 79 percent of the decrease in 1986 budget authority is the result of decreasd highway and mass transit funding. Other major decreases from 1986 result from termination of Amtrak funding as well as new Coast Guard user fees.

Highlights of the major programs in this function are as follows:

- Mass Transit - The budget proposes elimination of Washington Metro grants and the Section 3 capital grants. Only mass transit formula grants, planning, and assistance to the elderly and handicapped, administration, and R&D would be funded in 1987. Mass transit formula grants programs would be funded in a new block grant totalling $3.3 billion. Certain other highway programs would also be funded within the block grant. The block grant would be funded only from the highway and mass transit trust funds -- no general revenues could be used.

  If the States and localities chose not to decrease the highway programs in the block grant from current levels, only $1.1 billion would be available for mass transit formula grant. This would represent a 66 percent reduction from 1986 estimated funding for mass transit.

An additional $100 million from the mass transit trust fund would be used for planning, administration, R&D and grants for the elderly and handicapped outside the block grant. Interstate transfer grants for mass transit would compete with interstate transfer grants for highways under the highway programs exclusive of the block grant.

Following is a comparison of the Reagan budget proposal for mass transit compared to preliminary CBO estimates of current policy for fiscal year 1986 and 1987 using the assumption described above for the block grant distribution between highways and mass transit.

(Budget authority in millions of dollars)

	FY 1986 Preliminary CBO Baseline	FY 1987 Preliminary CBO Baseline	FY 1987 President's Budget
Washington Metro	217	226	...
Formula Grants 1/	2,058	2,141	...
Operations	(837)	(875)	
Capital	(1,220)	(1,266)	
Discretionary Grants	1,053	1,096	...
Interstate Transfer Grants 2/	191	219	NA
Administrative Expenses	29	29	...
R&D	17	18	...
Block Grant (formula only)	...	...	1,120
Other Funding 3/	NA	NA	100
Total UMTA	3,565	3,729	1,220

1/ Formula grants would be funded under the block grant under the President's 1987 budget request.

2/ The President's 1987 budget would allow Interstate grants to be eligible for funding under the highway trust fund.

3/ Composed of administrative expenses, R&D, planning and grants to elderly and handicapped.

- Federal Aid Highways - The budget for the Federal-aid highway and bridge program proposes $10.55 billion in budget authority exclusive of the block grant program. Assuming $2.2 billion in budget authority would be used for highways under the block grant program, the total budget authority in 1987 for all Federal aid highway construction and repair programs is $12.75 billion. The 1986 preliminary CBO baseline estimate for Federal-aid highways is $14.70 billion in budget authority. For 1987, the preliminary CBO baseline estimate for highways is $15.30 billion in budget authority.

  The proposed budget would transfer $2.2 billion in locally-oriented highway programs such as urban and secondary, to the new ground transportation block grant which will also fund the majority of mass transit programs.

The budget request assumes a 1987 total highway obligation of $12.40 billion compared to $12.20 billion in 1986 and $12.70 billion in 1987 preliminary CBO baseline estimate.

- Railroads - The budget proposes elimination of Federal funding for AMTRAK. The preliminary CBO baseline estimate for this program is $562 million in 1986 and $613 million in 1987.

  The budget also assumes revenues of $1.2 billion in 1986 from the sale of Conrail. This amount is reflected in the budget under Function 950: Undistributed Offsetting Receipts.

- Federal Aviation Administration - The budget proposes budget authority of $1,017 million for grants-in-aid, $825 million for facilities and equipment, $135 million for research and development, and $2,800 million for operations. The 1986 preliminary CBO baseline estimate for these programs is $973 million for grants-in-aid, $950 million for facilities and equipment, $182 million for research and development, and $2,579 million for operations. The preliminary 1987 CBO baseline estimate for these programs is $1,017 million for grants-in-aid, $987 million for facilities and equipment, $209 million for research and development and $2,635 million for operations.

- Coast Guard - The budget proposes budget authority of $1,833 million for operations and $77 million for acquisition, construction, and improvement (ACI). The 1986 preliminary CBO baseline estimate is $1,557 million for operations and $208 million for ACI. (An additional $323 million for Coast Guard vessel procurement and O&M was provided in 1986 under the Department of Defense appropriation bill with these amounts reflected in Function 050: National Defense.) The 1987 preliminary CBO baseline estimate is $1,605 million for operations and $218 million for ACI.

  The budget also assumes new recreational and commercial mariner user fees with receipts of $242 million in fiscal year 1987, rising to $480 million in 1988 and staying at this level in the outyears. Once full implementation was achieved, the new user fees would recover about 25 percent of Coast Guard operating costs.

MAJOR ISSUES

1. Ground Transportation Block Grant

The budget proposes a new ground transportation block grant program which is composed of locally oriented highway programs plus the bulk of mass transit programs. The block grant would be funded at about $3.3 billion in 1987 and would be financed only by highway and mass transit trust fund accounts. Assuming the states and localities chose to maintain highway programs at current levels of $2.2 billion, $1.1 billion would be available for mass transit funding under the block grant compared to $3.6 billion provided in 1986. Such drastic reductions in federal support for mass transit have been consistently rejected by previous Congresses.

2. Highways

The budget provides funding of about $10.55 billion for nationally oriented highways programs, such as the interstate and primary systems, not contained in the block grant described above. This results in a reduction in non-block grant highway programs of about $1.9 billion from current 1986 funding levels. The administration justifies this reduction in part on the need to maintain solvency of the trust fund.

3. Amtrak

Congress has consistently rejected major reductions or the termination of the Amtrak subsidy as proposed by the administration in previous budgets. The budget indicates that elimination of Federal support for Amtrak would probably result in the bankruptcy of Amtrak. It also notes that all remaining Amtrak obligations, including labor protection, would still need to be paid and that this could be achieved through the sale of Amtrak assets. However, labor protection costs under current law are estimated at over $2 billion and the sale of Amtrak assets, if they could be sold, might not cover this obligation.

4. Coast Guard User Fees

The budget proposes increasing Coast Guard user fees from about $4 million to $242 million in 1987 and to a level of $480 million in 1988 and subsequent years. These fees would recover both direct services and indirect services from commercial and recreational mariners. The budget assumes these fees would cover about 25 percent of Coast Guard operating costs by full implementation in 1988. Congress has consistently rejected increased user fees for Coast Guard services with particular concerns about user fees for recreational boat owners. The Administration's budget assumes a fee of about $20 a year per recreational boater for services such as search and rescue.

PERSPECTIVES

Actual 1985 funding for transportation programs was $29.55 billion in budget authority compared to the President's 1987 request of $22.55 billion. Enactment of the President's 1987 budget would represent a 24 percent reduction in transportation funding within two years. Congress may be concerned about such a drastic reduction in federal support for transportation programs particularly in light of national priorities for infrastructure needs, Coast Guard drug interdiction activities, and air safety. In all three of these areas, reductions of 26 percent, 10 percent and 13 percent respectively would occur under the President's 1987 budget compared to actual 1985 funding.

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Coast Guard ACI.....	0.35	0.45	0.20	0.45	0.20	0.40	0.20	0.45	0.20	0.45	0.10	0.35
Coast Guard User Fees.....	*	*	*	*	*	*	*	*	*	*	-0.25	-0.25
Cargo Preference Differential	...	...	0.05	0.05	...	...	0.10	0.10	0.05	0.05	...	...
Maritime Operating Subsidies	0.35	0.35	0.35	0.30	0.30	0.30	0.35	0.30	0.35	0.30	0.30	0.30
Other.....	0.05	0.15	0.15	0.20	0.20	0.25	0.25	0.25	0.15	0.20	0.20	0.25
Subtotal.....	3.10	3.20	3.20[2/]	3.50	3.10	3.40	3.20	3.45	3.00	3.30	2.65	2.90
Other.....	0.15	0.15	0.15	0.15	0.15	0.15	0.10	0.15	0.15	0.10	0.10	0.15
TOTAL.....	29.55	25.85	28.00	27.45	27.55	27.10	29.05	27.60	27.80	27.10	22.55	25.50

*Less than $25 million.

1/ The President's 1987 budget proposes a block grant program for some highway programs and most mass transit programs. The amounts shown reflect an assumption that the distribution under the block grant would maintain the block grant highway programs at current levels.

2/ The Department of Defense Appropriations Act for fiscal year 1986 (in the Continuing Resolution) also provides $223.5 million under Coastal Defense for procurement of vessels to be used by the Coast Guard and $100 million under Navy operations and maintenance for reimbursement to the Coast Guard for operation costs. These amounts are reflected in Function 050: National Defense.

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 450: COMMUNITY AND REGIONAL DEVELOPMENT

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	8.15	6.80	3.80	4.95	4.85
Outlays	7.70	7.90	6.55	5.45	4.95
CBO Baseline (Preliminary)					
Budget Authority	8.15	6.90	7.20	7.85	8.40
Outlays	7.70	8.00	7.95	8.05	8.00
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-0.10	-3.40	-2.90	-3.55
Outlays	...	-0.10	-1.40	-2.60	-3.05

HIGHLIGHTS

This function includes programs which provide Federal assistance for community and economic development in urban and rural communities and regions including assistance to Indians and various disaster and other emergency assistance programs. Major programs in this function include Community Development Block Grants (CDBG) which represents under current policy, approximately 40 percent of the function, the Urban Development Action Grant (UDAG) program, and three rental housing programs, various Farmers Home Administration programs, rural assistance programs, the Economic Development Administration (EDA), the Appalachian Regional Commission (ARC), development assistance programs for the Tennessee Valley Authority (TVA) and Indian assistance programs, the Small Business Administration (SBA) disaster loan program, and various Federal Emergency Management Agency programs.

The President's 1987 budget proposes $6.80 billion in budget authority and $7.90 billion in outlays for this function for fiscal year 1987, which is $0.10 billion less in both budget authority and outlays than the CBO preliminary baseline.

The President's budget proposes a $500 million deferral in the principle development program, the Community Development Block Grant program (CDBG). The CDBG program would have a program level of $2.6 billion in both fiscal years 1986 and 1987 compared to the current policy levels of $3.0 billion and $3.1 billion, respectively.

Other major program changes include the termination of the urban development action grant program, the economic development administration, the various rental housing assistance programs, the Farmers Home Administration rural development loan and grant programs, the Appalachian Regional Commission, the Tennessee Valley Authority development programs and the Small Business Disaster Loan program. Additional significant program changes include an increase in the rural share of the CDBG program, a reduction in the Federal share of the disaster relief program and a phased in full recovery of Federal costs in the National Flood Insurance program.

Highlights of the major program proposals in this function are as follows:

Community Development Programs:

- Community Development Block Grants (CDBG) - The budget proposes $2,990 million in budget authority for the CDBG program in 1986 with $500 million of the funding deferred until 1987. For 1987, the budget requests $2,125 million in new budget authority and the 1987 program level including the $500 million 1986 defferal would be $2,625 million. The proposed budget would also change the statutory distribution between urban and rural areas from the current 70 urban/30 rural to 65/35. The budget also proposes "to reform the process through which CDBG grants are distributed to mitigate the effect of these reductions on communities with the greatest need".

- Urban Development Action Grants (UDAG) - The budget proposes the termination of the UDAG program and rescission of $220 million of 1986 funds. The UDAG program is currently funded at $316 million for fiscal year 1986.

- Rental Housing Programs - The budget proposes the termination of the rental assistance programs in this function. The Section 312 rehabilitation loan fund would be terminated in 1986 with only $11 million of the estimated available $85 million loan repayments utilized. The budget also proposes the termination in 1986 of the rental development grant program (HoDAG) and the renatal rehabilitation program and rescission of the remaining $75 million in 1985 funding for each of these programs. The rental development and rental rehabilitation grant programs are both funded at $75 million in the current level.

Area and Regional Development:

- Economic Development Administration (EDA)-- The budget proposes the termination of EDA in fiscal year 1986 with a proposed $110 million rescission. The EDA current funding level is $25 million for salaries and expenses and $176 million for program costs.

- Appalachian Regional Commission (ARC)-- The budget proposes the termination of the ARC programs in 1986 and proposes a rescission of $81 million of 1986 funding. In the past, the President has proposed that the ARC highway programs would be transferred to the Federal Highway Administration (FHA), this proposal gives the FHA responsibility for the "closeout" of the program.

- Tennessee Valley Authority (TVA)-- The budget proposes the termination of direct support for TVA's regional development programs except for continuation of the TVA's basic responsibilities for water resources systems management and the national fertilizer research program. TVA funding would decline from $100 million in budget authority in 1986 to $58 million in 1987.

- Rural Development Programs-- The budget proposes the termination of the Farmers Home Administration rural development programs. The rural development insurance fund (RDIF) program would be terminated in fiscal year 1987. The RDIF program is estimated to provide $340 million in water and waste disposal loans, and $100 million each for community facilities and industrial development loans in 1986. A pilot program would also be started in 1987 to sell off the RDIF loan portfolio to institutional and private investors. The budget also proposes the termination of the rural water and waste disposal grant program in 1987. The current level for this program is $109 million.

- Indian Assistance programs-- The budget proposes a continuation of basic Federal Indian assistance programs in this function. Outlays for these various programs are estimated at $1.1 billion for each of fiscal years 1986 and 1987. the budget does project a smaller Indian construction program in fiscal year 1987 and no new budget authority for the Indian road construction program which was funded at $5 million in fiscal year 1986.

Disaster Relief and Insurance

- Small Business Disaster Loans-- The budget proposes the termination of the Small Business Administration (SBA) disaster loan program in 1987 and sale by the Department of Treasury of the existing loan portfolio.

- Federal Emergency Management Agency Disaster Relief Program-- The budget proposes a supplemental request of $250 million in budget authority for 1986 to refinance the depleted fund. The budget also proposes to revise downward the Federal share of this program according to a sliding scale based on severity of the disaster.

- National Flood Insurance Fund-- The budget proposes reforms in the program to fully recover all Federl costs in operating the program. The reforms will include rate increases, coverage changes and optional deductibles.

MAJOR ISSUES

1. Community Development Block Grants - The budget proposes a $500 million deferral in fiscal year 1986 which would reduce the CDBG program level from $3.1 billion to $2.6 billion. The recommended fiscal year 1987 program level would be $2.6 billion. The proposed budget also assumes a redistribution from the current 70 percent urban 30 percent rural formula to a 65/35 split. The shift to the rural program is in part an attempt to offset the termination of several rural programs in this function.

2. Program Terminations - The President's budget terminates many programs in this function as part of his effort "to cut back categorical local economic development subsidy programs". These terminations include:

   - Urban Development Action Grants - The budget proposes the termination of the UDAG pogram in 1986 and the rescission of $220 million in unused funds. The UDAG program is funded at $316 million in the current level and $332 million in the CBO preliminary baseline for 1987.

   - Economic Development Administration - The budget proposes termination in 1986 and the rescission of $110 million in unspent funds. The EDA program is funded at $176 million in the 1986 current level and $185 million in the CBO 1987 preliminary baseline.

   - Rental Assistance programs - The budget proposes the termination in 1986 of three rental assistance programs in this function. The section 312 rehabilitation loan fund would be terminated along with the rental development grant program (HoDAG) and the rental rehabilitation program. The

section 312 program is funded solely by loan repayments. The rental development grant program and the rental rehabilitation program are both funded at $72 million in the current level. The President proposes to rescind the full funding for the rental rehabilitation and development grant programs.

- Appalachian Regional Commission - The budget proposes the elimination of the ARC programs in 1986 and the rescission of $81 million. The ARC programs are funded at $115 million in the current level and $120 million in the CBO preliminary 1987 baseline.

- Tennessee Valley Authority - The budget proposes the termination of the TVA programs with two exceptions at the end of 1986. The proposal would continue the national fertilizer research program and TVA's major water resource responsibilities. Funding would be $58 million in 1987 compared to a current level of $100 million and a CBO preliminary 1987 baseline of $104 million.

- Rural Development Programs - The budget proposes the termination of the Rural Development Insurance Loan Fund (RDIF) loan programs and the rural water and wastewater grant program. The RDIF 1986 loan level included $325 million for water and wastewater disposal direct loans, $96 million for community facilities direct loans and $96 million for industrial development guaranteed loans. The rural water and wastewater grant program is funded at $109 million in the current level and $115 million in the CBO 1987 preliminary current policy baseline.

- Small Business Administration - (SBA) disaster loans - The budget proposes the termination of the SBA disaster loan program and the sale of the existing SBA loan portfolio. The 1986 current loan level for the SBA disaster program is $574 million and the CBO preliminary 1987 baseline is $842 million. The sale of the existing SBA loan portfolio would entail selling the assets at very deep discounts.

PERSPECTIVES

The budget proposals in the community and regional development function are a continuation of this administrations policy of promoting a devolution of Federal responsibilities to the States and local governments. The major issues in this function include the significant reduction in community development block grant funding for both 1986 and 1987 and the proposed termination of the UDAG, EDA, TVA, ARC, RDIF, rural wastewater and SBA disaster loan programs. It is important to note that funding for these programs have already been significantly reduced over the last five years. At the same time the Congress has continued to provide funding for these programs.

The major community development program in this function is the CDBG program which was funded at $3,752 million in 1980, $2,990 million in the current level and $3,135 million in the CBO preliminary 1987 baseline. The budget proposes to reduce this program to a $2.6 billion progam level in both 1986 and 1987 but does not suggest any programatic reason why or how the $2.6 billion level was derived. The President further suggests that this reduced CDBG program level can accomodate program needs associated with funding deriving from the termination of various rural development programs, including the RDIF and the rural water and wastewater grant program. To accomodate the increased rural program demand the President proposes a change in the CDBG formula from 30 percent rural to 35 percent rural - obviously the funding available for urban areas would be reduced an equal amount.

FUNCTION 400: TRANSPORTATION

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Ground												
Federal Aid Highways[1].....	14.90	12.60	14.70	13.70	14.70	13.65	15.30	13.30	14.70	13.20	12.75	13.20
Mass Transit[1].....	4.15	3.35	3.55	3.65	3.25	3.45	3.75	3.95	3.55	3.90	1.20	3.30
Amtrak.....	0.70	0.75	0.55	0.70	0.55	0.65	0.60	0.65	0.55	0.55	...	0.05
Other.....	0.55	0.90	0.50	0.80	0.45	0.85	0.55	0.80	0.50	0.85	0.40	0.70
Subtotal.....	20.30	17.60	19.30	18.85	18.95	18.60	20.20	18.70	19.30	18.50	14.35	17.25
Air												
FAA Airport Improvement....	1.00	0.80	0.95	0.80	0.95	0.80	1.00	0.85	0.95	0.85	1.00	0.85
FAA Facilities and Equipment	1.35	0.45	0.95	0.70	0.95	0.70	1.00	0.85	0.95	0.85	0.85	0.85
FAA Operations.....	2.70	2.70	2.60	2.50	2.65	2.55	2.65	2.65	2.60	2.60	2.80	2.70
FAA Research.....	0.25	0.25	0.20	0.25	0.20	0.25	0.20	0.20	0.20	0.20	0.15	0.20
NASA Aeronautics.....	0.65	0.65	0.60	0.60	0.60	0.60	0.65	0.65	0.60	0.60	0.70	0.65
Other.....	0.05	0.10	0.05	0.10	*	0.05	0.05	0.10	0.05	0.10	-0.05	-0.05
Subtotal.....	6.00	4.90	5.35	4.95	5.35	4.95	5.55	5.30	5.35	5.20	5.45	5.20
Water												
Maritime Loan Defaults.....	0.15	0.25	0.60	0.60	0.50	0.50	0.40	0.40	0.40	0.40	0.10	0.10
Coast Guard Retired Pay....	0.35	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Coast Guard Operations.....	1.75	1.70	1.50[2]	1.55	1.55	1.60	1.55	1.60	1.50	1.55	1.85	1.80

The proposed reduction in CDBG funding should also be viewed in the context of the Administration's other community development proposals which include the termination of most of the remaining community development programs as well as the assumption that the $4 billion General Revenue Sharing program will not only be terminated at the end of 1986 but, in addition that, the 1986 fourth quarterly payment will be rescinded.

The President's community and regional development proposals assume that the States and localities are able to assume additional responsibilities and that the loss of these programs is not considerable because these programs tended to misdirect resources rather than create new resources. The President's proposals are challenged by three issues, the continued high levels of economic distress and poverty in many localities, the unequal fiscal and economic health of many states and localities and the question as to what degree of success or failure each of these programs achieved.

In the past the President has proposed two new Federalism proposals which also sought a significant devolution of responsibility from the Federal to the State and local level. However, in earlier proposals the concept of shifting fiscal resources along with fiscal responsibilities were part and parcel of the same proposal. The current community development proposals shift responsibilities to states and localities but the issue of the ability of many local and State governments to meet the "fiscal responsibiities" is not very clear.

When viewed on a total functional basis the President's proposal for fiscal year 1987 is $3.40 billion in the budget authority and $1.40 billion in outlays below the CBO preliminary baseline estimate. By 1989 the President's proposed funding for this fucntion is $3.55 billion in budget authority and $3.05 billin in outlays below the CBO preliminary baseline or an approximate 40 percent reduction in spending.

FUNCTION 450: COMMUNITY AND REGIONAL DEVELOPMENT

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Community Development												
HUD Salaries and Expenses..	0.20	0.15	0.20	0.20	0.20	0.15	0.20	0.20	0.20	0.20	0.20	0.15
Rental Assistance Grants...	...	0.30	0.15	0.20	...	0.25	0.15	0.30	0.15	0.25	...	0.25
Community Development Block Grants.....	3.45	3.80	3.00	3.55	3.00	3.60	3.15	3.30	3.00	3.30	2.15	3.10
Community Development Section 108 Loan Guarantees	0.10	0.10	0.10	0.05	0.10	0.05	0.15	0.05	0.10	0.05	0.10	0.05
Urban Development Action Grants.....	0.45	0.50	0.30	0.50	0.10	0.50	0.35	0.45	0.30	0.45	...	0.40
All Other.....	0.05	-0.25	0.10	0.05	0.10	0.05	...	0.05	0.10	0.05	...	-0.05
Subfunction 451, Subtotal	4.25	4.60	3.85	4.55	3.50	4.60	4.00	4.35	3.85	4.30	2.45	3.90
Area and Regional Development												
Appalachian Regional Development Program.....	0.15	0.20	0.10	0.15	0.05	0.15	0.10	0.15	0.10	0.15	...	0.10
Tennessee Valley Authority.	0.15	0.15	0.10	0.15	0.10	0.15	0.10	0.10	0.10	0.10	0.05	0.10
FmHA Salaries and Expenses.	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40
Rural Telephone Bank.....	0.15	0.05	0.15	0.05	0.10	0.05	0.15	0.05	0.15	0.05	0.05	-*
Rural Water and Waste Disposal Grants.....	0.10	0.20	0.10	0.20	0.10	0.20	0.10	0.15	0.10	0.15	...	0.15

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 500: EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	32.35	28.60	26.95	26.65	26.55
Outlays	29.35	30.65	27.45	26.30	26.45
CBO Baseline (Preliminary)					
Budget Authority	32.35	30.25	31.75	33.05	34.45
Outlays	29.35	30.75	30.75	31.95	33.20
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-1.65	-4.80	-6.40	-7.90
Outlays	...	-0.10	-3.30	-5.65	-6.75

HIGHLIGHTS

This function primarily covers programs which provide assistance to State and local governments for education, employment, training, and social services. In addition, several programs provide assistance to individuals in order that they might continue their education after high school. President Reagan's fiscal year 1987 budget is $1.65 billion in budget authority and $0.10 billion in outlays below the preliminary CBO 1987 baseline for these programs.

Highlights of major programs in this function are as follows:

- Elementary, Secondary, and Vocational Education -- The budget proposes $7.25 billion in budget authority and $7.35 billion in outlays for elementary and secondary education programs in fiscal year 1987. The proposed funding is $0.80 billion in budget authority and $0.40 billion in outlays below the preliminary CBO baseline for fiscal year 1987 and $0.35 billion in budget authority and $0.35 billion in outlays below the fiscal year 1986 current level. The budget also includes fiscal year 1986 rescission proposals totalling $329 million for various elementary and secondary education programs. The budget proposes the elimination of Impact Aid, Part B, which is currently funded at $124 million and the $29 million immigrant education programs as well as a 44 percent cut in vocational and adult education which is currently funded at $907 million. The budget also includes a new initiative of $75 million for a new teacher training and improvement program to replace the math-science teacher training program which is currently funded at $52 million. The budget again includes a proposal for elementary and secondary school tuition tax credits for families with incomes below $60,000 who send their children to private schools, which would result in a revenue loss of $0.4 billion in 1987, rising to $0.9 billion by 1989.

- Higher Education -- The 1987 budget proposes $6.75 billion in budget authority and and $6.80 billion in outlays for higher education, which is $2.25 billion in budget authority and $1.85 billion in outlays below the fiscal year 1987 preliminary CBO baseline and $1.90 billion in budget authority and $1.95 billion in outlays below the fiscal year 1986 current level. The budget includes proposals to significantly alter the Federal student aid programs and affects students, lenders, and educational institutions. Three year savings, fiscal years 1987-89, in the guaranteed student loan program would total $3.2 billion while savings from the discretionary student aid programs, such as Pell grants and college work study, would also equal $3.2 billion over 3 years. The total number of student aid awards are estimated to decline by 1 million per year from the fiscal year 1985 (1985-86 school year) total of 9.3 million to 8.3 million awards in fiscal year 1986 and 7.3 million awards in fiscal year 1987.

- Training and Employment -- The budget proposes a fiscal year 1987 funding level of $4.25 billion in budget authority and $4.45 billion in outlays for employment and training programs. This is $0.90 billion in budget authority and $0.50 billion in outlays below the 1987 preliminary CBO baseline and $0.65 billion in budget authority and $0.85 billion in outlays below the fiscal year 1986 current level. The budget includes proposals to cut the two youth programs--Job Corps (currently funded at $613 million) and summer youth employment (currently funded at $636 million), by 43 percent and 33 percent, respectively and again includes a proposal to eliminate WIN which is currently funded at $211 million.

- Social Services -- The budget proposes a fiscal year 1987 funding level of $6.90 billion in budget authority and $6.90 billion in outlays for social services programs. This is $0.55 billion in budget authority and $0.50 billion in outlays below the 1987 preliminary CBO baseline and $0.20 billion in budget authority and $0.10 billion in outlays below the fiscal year 1986 current level. The administration is again proposing to eliminate the community services block grant (fiscal year 1986 post Gramm-Rudman funding is $354 million) based on the rationale that its activities can be maintained by the job training partnership act (JTPA) and the social services block grant (Title XX).

MAJOR ISSUES

1. Elementary, Secondary, and Vocational Education

The fiscal year 1987 budget for elementary, secondary, and vocational education programs is reduced by 3 percent from the fiscal year 1986 funding level. The $124 million Impact Aid, Part B, and the $29 million immigrant education programs would be eliminated and the vocational and adult education program would be reduced by 44 percent from the fiscal year 1986 funding level of $907 million. The Chapter 1, compensatory education program, would be increased by $151 million to $3,688 million -- almost to the pre-Gramm-Rudman fiscal year 1986 funding level. The administration is also proposing a $75 million initiative for teacher training and improvement to replace the existing $52 million math-science teacher program. The table below details the President's budget request for the major education appropriation accounts.

ELEMENTARY, SECONDARY, AND VOCATIONAL EDUCATION PROGRAMS

(Budget authority in millions of dollars)

	FY 1986			Reagan Budget	
	Labor-HHS-Ed Appropriation	Gramm-Rudman Reduction	Revised Appropriation	FY 1986 Rescissions	FY-1987 Request
(By appropriation account)					
Compensatory Education.	3,696	-159	3,537	-7	3,688
Handicapped Education..	1,411	-61	1,350	-44	1,303
Vocational and Adult Education.....	948	-41	907	-210	512
Special Programs/ Chapter 2.....	705	-30	675	-38	679
Impact Aid.....	693	-30	663	...	548
Bilingual/Immigrant Education.....	173	-7	167	-29	143

- Compensatory Education -- The fiscal year 1987 budget request for all compensatory education programs (Chapter 1, migrants, and State programs) is $3,688 million, a reduction of $7.5 million from the fiscal year 1985 appropriation and an increase of $151 million over the fiscal year 1986 adjusted appropriation. The Chapter 1 program, grants to local education agencies, would be increased by almost $200 million over the fiscal year 1986 appropriation level of $3,062 million and $61 million over the fiscal year 1985 funding level of $3,200 million. The administration is proposing that funding for the two migrant programs (high school equivalency and migrant college assistance ($7.5 million in fiscal year 1985 and $7.2 million in fiscal year 1986) be included in a new consolidated higher education program for disadvantaged students.

- Impact Aid, Part B -- The fiscal year 1987 budget contains no new funding for Part B, Impact Aid. This program, which is funded at $124 million in fiscal year 1986, provides assistance to local school districts for children whose parents either work or reside on Federal property.

- Immigrant Education -- The fiscal year 1987 budget again proposes to terminate the immigrant education program which is funded at $29 million in fiscal year 1986. The administration has included a fiscal year 1986 rescission request of $29 million for this program The fiscal year 1986 budget also requested no new funds for the program.

- Vocational and Adult Education -- The fiscal year 1987 budget proposes to fund vocational and adult education at $512 million, $399 million less than the fiscal year 1986 appropriation level of $907 million. The administration is proposing to reduce the funds available to vocational education by eliminating funding for community-based organizations (fiscal year 1986 funding is $47 million) and consumer and homemaker education (fiscal year 1986 funding is $30 million) and reducing the vocational education basic grant program by $361

million (48 percent) from the fiscal year 1986 appropriation of $749 million. Further, the administration proposes "the basic grant program be available only to serve the disadvantaged, handicapped, women, and other "nontraditional" students". As part of the fiscal year 1987 reduction the administration is proposing a fiscal year 1986 rescission of $210 million in vocational education funding.

- Teacher Training and Improvement -- The fiscal year 1987 budget proposes to replace the existing math-science teacher training program and two smaller teacher programs (total fiscal year 1986 funding is $52 million) with a new and broader teacher training and improvement program. The fiscal year 1987 funding for this program would be $75 million. The new program would not be limited to teachers in math and science but open to all teaching disciplines.

2. Higher Education

The fiscal year 1987 Reagan budget for higher education is reduced substantially -- 22 percent -- from the fiscal year 1986 funding levels. Funding would decline from the $8.65 billion in budget authority available in fiscal year 1986 to $6.75 billion in fiscal year 1987. In addition, the budget includes major changes in the way aid is provided to students and institutions. The administration is proposing to consolidate the college work-study (CWS) and supplemental education opportunity grant (SEOG) programs and reduce the funding by 58 percent from the fiscal year 1986 level of $962 million to $400 million; restructure the national direct student loan (NDSL) program; and eliminate the state student incentive grant (SSIG) program which was funded at $73 million in fiscal year 1986. General aid to higher education would decline by 40 percent, from the post Gramm-Rudman level of $436 million appropriated in fiscal year 1986, to $262 million in fiscal year 1987. Guaranteed student loans, an entitlement program, would be reduced substantially by proposed changes in the current law. The table below details the President's budget request for higher education programs.

HIGHER EDUCATION PROGRAMS
(Budget authority in millions of dollars)

	FY 1986			Reagan Budget	
	Labor-HHS-Ed Appropriation	Gramm-Rudman Reduction	Revised Appropriation	FY 1986 Rescissions	FY-1987 Request
Guaranteed Student Loans.....	3,300	-34	3,266	...	2,330
Student Financial Assistance:					
-- Pell Grants...	3,588	-154	3,434	...	3,000
-- State Incentive Grants (SSIG).	76	-3	73	-73	...
-- National Direct Student Loans..	218	-9	209	-182	163
-- Work Study....	592	-25	567	-65	...*
-- Supplemental Opportunity Grants (SEOG).	413	-18	395	-137	...*
-- Proposed Work/ Grant Program	NA	NA	NA	NA	400
Higher Education					
-- Developing Institutions....	141	-6	135	...	141
-- TRIO.....	176	-8	168	-86	82

*See proposed Work/Grant Program.

- General Student Aid Proposals -- The administration is proposing a number of "universal" changes to all student aid programs. These proposals include:

  -- a single needs analysis test for all students and all programs;
  -- a requirement that students have either a high school diploma or its equivalent;
  -- a requirement that a student must contribute $800 ("self-help") towards his or her education (college work study or loans could be used to meet this requirement);
  -- a requirement that a student can only receive undergraduate aid for five years;
  -- a requirement that a student must be enrolled in a program which leads to either a diploma or certificate;
  -- a provision to allow the Secretary to sell defaulted loans to private collectors after all other collection efforts have failed; and
  -- a termination of administrative cost allowance payments to schools and institutions.

- Pell Grant Funding Shortfall -- An issue raised in the budget is the financing of the Pell grants, a program which provides grants to undergraduate students from low-income families. Continued annual underestimating of Pell grant program costs have resulted in a cumulative funding shortfall of approximately $859

million: $490 million of which is related to pre-1986 appropriations, $215 million to the regular fiscal year 1986 appropriation and $154 million to the fiscal year 1986 Gramm-Rudman sequestration. The budget proposes to finance the pre-1986 shortfall ($490 million) over the next two years and to implement the statutory linear reduction schedule for the total fiscal year 1986 shortfall ($369 million).

The fiscal year 1986 appropriation mandates a $2,100 maximum Pell grant award (up to 60 percent of the cost of the student's attendance at the post-secondary institution). The statutory linear reduction schedule would not affect those students receiving the highest Pell awards (between $1,900 and $2,100). The reductions would be applied to awards below $1,900 and be applied inversely to the student's need. Preliminary data from the administration indicates that up to 290,000 otherwise eligible students will not receive Pell grants in the 1986-87 school year, and an additional undetermined number will have their awards reduced.

- Guaranteed Student Loans (GSLs)--The Reagan administration again is proposing a number of changes to the GSL program--some of which have been proposed in the past. The administration assumes outlay savings of: $49 million in fiscal year 1986, $855 million in fiscal year 1987, $1,255 million in fiscal year 1988, and $1,109 million in fiscal year 1989 -- a total savings of $3,268 million. In addition to the universal student aid proposals discussed above, the administration is proposing:

  -- to eliminate all interest benefits to students by allowing them to either (1) pay the interest on the loan while the student is in school or (2) borrowing the additional funds necessary to pay the interest on the loan during the in-school period. The latter option could increase student indebtedness by approximately 25 percent.

  -- to change the interest rate charged to borrowers from 8 percent while the student is in-school to the current T-bill rate. This interest rate would apply while the student is in-school and for the first two years of repayment. After 2 years of repayment the interest rate would become the T-bill plus 3 percent. The special allowance for lenders would be set at a flat 3 percent while the student's interest rate is 3 percent and would cease when the student's interest rate went to T-bill plus 3 percent.

  -- to eliminate all administrative cost allowances for and recall all advances from State guarantee agencies in fiscal year 1987, as well as revise the re-insurance rates for those agencies, thus exposing the guarantee agencies to more financial risk.

  -- to substitute a 5 percent guarantee (risk) fee on all GSLs for the current 5 percent origination fee. (The risk fee on PLUS loans, the parent loan program, would be 1 percent.)

  -- to extend the maximum period for loan repayment from 10 to 15 years and to allow for loan consolidation.

- National Direct Student Loans (NDSL) -- The administration is proposing to significantly restructure the NDSL program. In lieu of the current 5 percent interest payment on an NDSL, the administration is proposing a variable interest

rate (T-bill plus 3 percent) and that the repayment of loans will be based upon an individuals income (income-contingent loan repayment schedule). Payments would continue to be made after the student has left school. Through a combination of new capital contributions (appropriations) and requiring that Federal collections on "assigned" defaulted loans be available for new capital contributions rather than reverting to the Treasury, the administration is proposing that obligations available in fiscal year 1987 total $240 million and that the program would be increased by $50 million per year to $340 million in fiscal year 1990.

The current NDSL program would be terminated by rescinding the current capital contribution appropriation of $190 million. The new program would begin in fiscal year 1987 (the 1987-88 school year) and during the transition period, fiscal year 1986, schools would be able to make loans with only those funds available in their revolving fund account.

- Higher Education Programs -- The fiscal year 1987 budget proposes to eliminate most of the categorical grants and scholarship programs, restructure a reduced TRIO program and fund the Title III historically Black colleges at the fiscal year 1985 (and pre-Gramm-Rudman fiscal year 1986) level of $141 million.

  -- TRIO: The administration is proposing to reduce funding for the TRIO programs by 51 percent, from the $168 million appropriated in fiscal year 1986 to to $82.4 million in fiscal year 1987. (The administration has proposed a fiscal year 1986 rescission of $86 million to bring the program level to $82.4 million in fiscal year 1986.) The administration is proposing to consolidate the current post-secondary categorical outreach programs into a single grant to post-secondary institutions.

- Loan Asset Sales -- The fiscal year 1987 budget proposes to sell the assets of two Education Department programs: college housing loans and defaulted and uncollected student loans.

  -- College Housing Loan Assets: the budget includes a proposal to sell the assets of college housing loans in fiscal years 1987 and 88. Schools would be able to buy their loans at a discount; others will buy them for market value. The sale of these assets is estimated to reduce the deficit by $0.85 billion during fiscal years 1987-88.

  -- Defaulted Student Loan Assets: The fiscal year 1987 budget includes a proposal to authorize the Secretary of Education to sell defaulted loans to private collectors after all other collection efforts have failed. The administration estimates that the sale of these problem loans will be valued at fifteen cents on the dollar and assumes three year savings of $0.15 billion.

3. Training and Employment

The fiscal year 1987 budget request for employment and training programs is substantially reduced for the fiscal year 1986 funding levels. The table below details the President's request. The administration is proposing a 43 percent cut in the $613 million Job Corps program, a 33 percent cut in $636 million summer youth employment program, and elimination of the $211 million work incentive (WIN) program. According to Labor Department documents, the two reductions in the youth

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Rural Development Insurance Fund.....	1.75	1.15	1.00	1.10	1.15	1.10	1.00	1.20	1.00	1.20	0.75	1.00
Economic Development Admin.	0.25	0.30	0.20	0.30	0.15	0.25	0.20	0.25	0.20	0.25	...	0.20
Operation of Indian Programs	0.50	0.55	0.50	0.50	0.50	0.45	0.50	0.50	0.50	0.50	0.50	0.50
Indian Construction.....	0.10	0.10	0.10	0.10	0.15	0.10	0.10	0.10	0.10	0.10	0.05	0.10
Indian Miscellaneous Trust Fund.....	0.40	0.35	0.45	0.35	0.45	0.45	0.45	0.35	0.45	0.35	0.45	0.50
Indian Intra-Budgetary Receipts.....	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
All Other.....	...	-0.05	...	...	-0.05	-0.05	0.10	0.05	...	...	...	-0.05
Subfunction 452, Subtotal	3.65	3.10	2.80	3.00	2.80	2.95	2.90	3.00	2.80	2.95	2.05	2.75
Disaster Relief Insurance												
Disaster Relief.....	0.10	0.20	0.10	0.25	0.35	0.30	0.10	0.30	0.10	0.30	0.10	0.25
National Flood Insurance...	...	-0.10	...	0.10	0.10	0.05	...	...	...	...	...	-0.05
SBA Disaster Loan Fund.....	...	-0.25	...	-0.10	...	-0.15	...	0.15	...	0.15	-0.90	-0.45
All Other.....	0.15	0.10	0.15	0.15	0.10	0.15	0.15	0.15	0.15	0.15	0.10	0.10
Subfunction 453, Subtotal	0.25	-0.05	0.25	0.40	0.55	0.35	0.25	0.60	0.25	0.60	-0.70	-0.15
TOTAL	8.15	7.70	6.90	8.00	6.80	7.90	7.20	7.95	6.90	7.85	3.80	6.55

programs, Job Corps and summer youth, would result in a decline of 411,000 youths participating in youth training and employment programs. In addition, the administration is continuing to support a sub-minimum wage for youth employed during the summer. The savings associated with the subminimum wage are not included in the overall budget estimates.

EMPLOYMENT AND TRAINING PROGRAMS

(Budget authority in millions of dollars)

	FY 1986			Reagan Budget	
	Labor-HHS-Ed Appropriation	Gramm-Rudman Reduction	Revised Appropriation	FY 1986 Rescissions/ Supplementals	FY 1987 Request
Job Training Partnership Act					
-- Basic State Grant.	1,863	-80	1,783	...	1,820
-- Job Corps.....	640	-27	613	-197	352
-- Summer Youth.....	665	-29	636	-208	428
-- Dislocated Workers.	100	-4	96	+74	100
-- National Programs..	193	-8	185	-12	210
TOTAL, JTPA.....	3,461	-148	3,313	-342	2,910
Work Incentive (WIN).....	220	-9	211	-46	...
Older Americans Employment.....	326	-14	312	...	326
Employment Service.....	997	-43	954	-4	951

- Job Corps -- Unlike last year when the administration proposed to eliminate the Job Corps, this year the administration is proposing to reduce the funding for the Job Corps program by 43 percent from the fiscal year 1986 appropriation level of $613 million to $352 million in fiscal year 1987. According to administration documents, average enrollment levels in the Job Corps program would decline from 38,000 in fiscal year 1985 to 22,000 in fiscal year 1987, thus reducing the number of youths who participate in the program from 100,000 to 60,000. Almost all of the reduction would take place during fiscal year 1986 through a rescission request of $197 million. The administration plans to close "poor performance, high costing centers" around the country. Currently there are 107 Job Corps Centers. Neither the criteria to be used in evaluating a center's performance nor a list of potential center closings is available.

- Summer Youth Employment Program -- The administration is proposing to reduce the funding for the summer youth employment program by 33 percent from the fiscal year 1986 appropriation level of $636 million to $428 million. According to administration documents this would reduce the number of disadvantaged youth to be employed from 785,000 in fiscal year 1985 to 414,000. Almost all of the reductions would take place in fiscal year 1986 through a rescission request of $208 million. In addition, the administration is proposing to authorize literacy training for those youth with identified academic deficiencies. Further, the

administration is proposing to target the funds to those areas where the highest concentration of disadvantaged youth live.

- Dislocated Workers -- The administration is proposing a fiscal year 1986 supplemental of $74 million to help offset "the severity of the dislocated worker problem, especially for those workers impacted by increased imports". This supplemental would increase the amounts available in fiscal year 1986 to $170 million. The administration's fiscal year 1987 request would take the program back down to $100 million. The administration is proposing that the Secretary of Labor have the discretion to allocate these funds rather than allocate them by the existing formula.

- Work Incentive (WIN) Program -- The administration is again propoosing to eliminate the WIN program. This proposal has been in every budget since 1983 and each time it has been rejected by the Congress. The fiscal year 1986 appropriation for WIN is $211 million. The administration is proposing a $46 million rescission in fiscal year 1986 in order to accelerate the program's termination.

4. Social Services

The fiscal year 1987 budget request for social services programs reflects previous budgets: elimination of the community services block grant and small reductions in other programs. The budget includes proposals to reduce funding for all all social services programs from the $7.10 billion available in fiscal year 1986 to $6.90 billion in fiscal year 1987 -- a 3 percent reduction. The table below details the President's budget request for the various social services programs.

SOCIAL SERVICES PROGRAMS

(Budget authority in millions of dollars)

	FY 1986			Reagan Budget	
	Labor-HHS-Ed Appropriation	Gramm-Rudman Reduction	Revised Appropriation	FY 1986 Rescissions	FY-1987 Request
Social Services (Title XX).....	2,700	-116	2,584	...	2,700
Community Services Block Grant.....	370	-16	354	-185	...
Child Welfare.....	207	-9	198	...	200
Foster Care and Adoption Assistance..	550	-7	443	...	604
Head Start.....	1,087	-47	1,040	...	1,075
Aging Programs.....	702	-30	672	...	689
Rehabilitation Services/ Research.....	1,362	-52	1,310	-75	1,225

- Title XX and the Community Services Block Grant (CSBG) -- The fiscal year 1987 budget again includes a proposal to eliminate funding for the CSBG assuming that its activities can be provided by the Title XX, social services, block grant. In addition, the administration is proposing that enrollees in the work incentive (WIN) program, also included on the administration's program elimination list, use

the supportive services provided by Title XX (training and employment services would be provided to WIN enrollees by the job training partnership program (JTPA). As shown in the table below, funding in fiscal year 1987 would be 8 percent ($238 million) below that which is currently available in fiscal year 1986 for Title XX and CSBG. Combining the resources provided for the WIN program into the Title XX/CSBG base and comparing it to the fiscal year 1986 funding shows a 14 percent decline. (NOTE: the administration also assumes that the Title XX program can provide a sufficient legal services program in lieu of the Legal Services Corporation which is currently funded at $292 million and is also included on the program elimination list.)

	FY 1985 Appropriation	FY 1986 Appropriation	FY 1987 Reagan Budget
Title XX	2,725	2,584	2,700
CSBG	372	354	...1/
Subtotal	3,097	2,938	2,700
WIN	267	211	...
TOTAL	3,364	3,149	2,700

1/ The administration has requested $4 million for administrative purposes to close-out the CSBG activities in fiscal year 1987.

PERSPECTIVES

Since 1980, spending in this function has undergone major changes. In fiscal year 1980, outlays totaled $30.75 billion, declining to $26.60 billion in fiscal year 1983, projected to be $30.75 in fiscal year 1986, and declining to $27.45 billion in the 1987 budget. During the first Reagan term, spending for elementary and secondary education declined then increased. Spending for training and employment programs declined and spending for social services programs declined slightly, then increased. The fiscal year 1987 budget continues the administration's position of reducing funding for training and employment programs, generally holds spending for elementary/secondary education and social services programs constant, and proposes major reductions in and modifications to higher education spending.

A number of proposals in the fiscal year 1987 budget have appeared in previous budgets: tuition tax credits, youth subminimum wage, education savings accounts, voucher programs for elementary and secondary students, and elimination of the work incentive (WIN) and community services block grant programs. Other proposals, such as student aid reforms, have appeared in different forms in each of previous budgets.

While overall spending is projected to be almost the same in fiscal year 1986 as in fiscal year 1980, the priorities within this functional category have shifted dramatically. In 1980, funding for elementary and secondary education programs accounted for 22 percent of the outlays in this function while in the fiscal year 1987 Reagan budget it would consume 27 percent of the outlays. Similarly, funding for

higher education would grow from 19 percent to 25 percent. Over the same period outlays for social services programs would grow from 20 to 25 percent. These increases as a percentage of spending within Function 500 have been offset by the reductions in spending for employment and training programs which in 1980 accounted for 34 percent of the total and in 1987 would account for 16 percent.

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 550: HEALTH

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	33.60	35.35	35.35	36.50	38.00
Outlays	33.55	35.65	35.00	36.65	37.95
CBO BASELINE (Preliminary)					
Budget Authority	33.60	36.40	39.10	42.05	45.10
Outlays	33.55	36.25	38.55	41.50	44.55
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-1.05	-3.75	-5.55	-7.10
Outlays	...	-0.60	-3.55	-4.85	-6.60

HIGHLIGHTS

This function covers most Federal programs which provide direct health care services. The largest program included in this function is medicaid, which finances health services for approximately 22 million low-income persons. Other health programs included in the function are designed to further national biomedical research goals, protect the health of the general population and workers in their places of employment, provide health services for underserved populations, and promote training for the health care work force. President Reagan's fiscal year 1987 budget requests $35.35 billion in budget authority and $35.00 billion in outlays for programs in this function. The 1987 funding request of $35.35 billion in budget authority represents a net decrease of $1.05 billion (3 percent) below the preliminary 1986 CBO baseline of $36.40 billion. The 1987 budget proposal for medicaid and other health programs is 10 percent below the preliminary 1987 CBO baseline.

- Medicaid -- The medicaid budget request of $24.70 billion reflects legislative savings of approximately $1.15 billion in 1987. The CBO preliminary baseline estimate for medicaid in fiscal year 1987 is $26.45 billion, which is $1.75 billion above the budget request. President Reagan has sought medicaid reductions in past budgets, some of which were adopted. The cap on medicaid spending and most other program changes included in the 1987 budget have been proposed in the past and rejected by the Congress.

Discretionary and Other Health Programs -- The budget authority request for other health programs within Function 550 is $10.65 billion in fiscal year 1987, which is $2.05 billion below the preliminary 1987 CBO baseline and $1.35 billion below the preliminary 1986 CBO baseline. Some of the major proposals are:

-- The elimination of health professions education and training, with 1986 savings of $0.10 billion and 1987 savings of $0.10 billion. These programs are funded at $0.25 billion in the preliminary 1987 CBO baseline. The budget also proposes to reduce health education loan guarantees to $100 million from the 1986 budget limit of $275 million.

-- A $0.20 billion reduction (3 percent) below the preliminary 1986 CBO baseline of $5.5 billion in health research, which is $0.45 billion (7.9 percent) below the $5.8 billion preliminary 1987 CBO baseline for health research.

-- Federal employee health benefits (FEHB) savings of $0.30 billion in budget authority and $1.2 billion in outlays in 1987. The proposal to reform FEHB appears to be a package that has been proposed and rejected in past years. It would restructure the program to base Federal contributions on a program-wide premium average rather than on the average of the six largest high-option premiums. The proposal would also lift the cap on the Federal contribution and increase the number of plans available to participants.

-- Indian health services reductions of $0.10 billion below the preliminary 1986 CBO baseline of $0.8 billion, and the termination of funding for Indian health facilities, funded at $0.05 billion in the 1986 and 1987 preliminary CBO baseline.

-- The 1986 appropriation level of $1.05 billion for block grants -- maternal and child health, preventive health, and alcohol, drug abuse, and mental health.

-- The termination of all Federal funding ($0.35 billion) for the Food Safety and Inspection Service and the imposition of meat and poultry inspection user fees to fund these services.

-- Minor increases over 1986 for the Occupational Safety and Health Administration (OSHA), the Mine Safety and Health Administration, and the Food and Drug Administration (FDA).

-- AIDS research request of $213 million, which is approximately $20 million below the 1986 appropriated level and the preliminary 1987 CBO baseline.

MAJOR ISSUES

1. Medicaid

The President's budget requests $24.70 billion in budget authority and outlays for the medicaid program in 1987. This is $1.75 billion below the preliminary 1987 CBO baseline of $26.45 billion in budget authority and outlays. The President's budget reflects proposed legislation to limit medicaid spending in 1987 through changes in the current system of open-ended Federal grants to States. The budget also proposes regulatory changes to require mandatory second surgical opinions, generic drugs, and expanded third party collections. The budget holds Federal medicaid spending in the outyears to the inflationary adjustments in the medical care component of the consumer price index (CPI). The medicaid reduction is offset in part by a $0.30 billion addition (one time) to assist States which have unusually high medicaid expenditures despite efforts to curb health care spending.

MEDICAID FUNDING
(Budget Authority in Millions of Dollars)

	CBO Baseline (Preliminary)		President's Budget		President's Budget Over(+)/Under(-) Current CBO Baseline	
	1986	1987	1986	1987	1986	1987
Current Law Program Estimate....	24,440	26,434	24,440	25,880	...	-554
Legislation....	...	...	...	-1,172*	...	-1,172
	24,440	26,434	24,440	24,708	...	-1,726

* Additional regulatory savings are proposed.

2. Discretionary and other health programs

The President's 1987 budget request of $10.65 billion in budget authority for other health programs compares to $12.65 billion in the preliminary 1987 CBO baseline. There are proposed reductions of approximately $2.0 billion in budget authority from the preliminary 1987 CBO baseline and $1.35 billion in reductions from the preliminary 1986 CBO baseline. These differences are due primarily to cuts in health research, health professions education and training, Indian health, the Federal employees' health benefits program, and the Food Safety and Inspection Service. The budget proposes the elimination of the health professions' Federal training subsidies since surpluses are projected for most health care disciplines. Health block grants would be held at approximately the 1986 appropriated funding level of $1.05 billion, which would be slightly higher than the post-sequestration levels in 1986. The budget again proposes the consolidation of community health centers, migrant health, black lung, and family planning grants at a combined 1987 funding level of $15 million below the preliminary 1986 CBO baseline. This block grant proposal was not accepted by the Congress in the past.

SELECTED DISCRETIONARY HEALTH FUNDING

(Budget authority in millions of dollars)

	CBO Baseline (Preliminary)		President's Budget		President's Budget Over(+)/-Under CBO Baseline	
	1986	1987	1986	1987	1986	1987
Indian Health						
-- Services	808	833	787	725	-21	-108
-- Facilities	46	48	8	0	-38	-48
Center for Disease Control	452	469	407	380	-45	-89
Alcohol, Drug Abuse, Mental Halth Block Grant	470	517	470	490	...	-27
Maternal & Child Health Block Grant	457	483	457	478	...	-5
Health Research	5,533	5,820	5,447	5,360	-86	-460
Health Professions Education & Training Grants	217	229	66	3	-151	-226
Food Safety and Inspection Services	347	353	346	0	-1	-353
Food and Drug Admin. (FDA)	402	410	404	424	+2	+14
Occupational Health & Safety (OSHA)	209	216	207	226	-2	+10
Community Health Centers	396	418	375	*	-21	NA
Family Planning	136	144	136	*	...	NA
AIDS Research	224**	235	183	213	-41	-22

* Again proposed for consolidation -- community health centers, black lung clinics, migrant health, and family planning at a combined funding level of $565 million in 1987, about $15 million below the 1986 CBO baseline for these programs.

** The fiscal year 1986 enacted level was $234; the 1986 baseline reflects the post-sequestration funding level.

HEALTH PERSPECTIVE

The Federal Government provides grants for a variety of health services, education, training and research. The majority of Federal health funding is targeted on direct health care and services for individuals, with the largest program in this function being medicaid which serves about 1 out of 10 Americans. Although the Federal Government is spending over $24 billion for medicaid, the program only covers 39 percent of individuals below the poverty threshold.

Health care expenditures increased at an average rate of nearly 13 percent between 1970 and 1983. Health spending slowed to 9.1 percent in 1984, the smallest increase in 19 years. The Federal Government paid for approximately 29 percent of all health expenditures in 1984-- nearly $112 billion.

For the past four years there have been many proposals to reduce Federal health care expenditures. President Reagan has sought medicaid reductions in each of his first term budgets, and medicaid payments to states were reduced in the Omnibus Reconciliation Act of 1981 (OBRA) by 3 percent in 1982, 4 percent in 1983 and 4½ percent in 1984, and States were provided with flexibility in program design and benefits. In addition, over 20 categorical programs were consolidated into four block grants with a funding level lower than that for the antecedent programs.

In 1982, the Tax Equity and Responsibility Act (TEFRA) authorized States to expand copayments to certain medicaid beneficiaries and impose property liens under certain conditions. The fiscal year 1984 and fiscal year 1985 budgets proposed the extension of the OBRA amendments and recommended that copayments be required on certain medicaid services. Although there were some savings achieved in 1984, there were net increases due to certain liberalizations included in the Deficit Reduction Act of 1984.

President Reagan's fiscal year 1986 budget proposed reductions of approximately $1.75 billion below the 1986 CBO baseline in medicaid and health education, training and research in order to curb spiraling Federal health care expenditures and the overall Federal deficit. The proposals were not adopted by the Congress.

In 1985, the Balanced Budget and Emergency Deficit Control Act (Gramm-Rudman) was enacted. The legislation mandated a balanced budget by fiscal year 1991, to be achieved by automatic across-the-board reductions in defense and domestic programs if other specific reductions are not made. This will result in fiscal year 1986 health program reductions of 4.3 percent, with the exception of medicaid, which is totally exempt, and community and migrant health centers, and Indian health, which are limited to a 1 percent reduction in fiscal year 1986 and 2 percent in 1987.

President Reagan's fiscal year 1987 budget includes many budget reduction proposals which have been rejected in the past. The medicaid reduction of over $1 billion will require States to either compensate for diminished Federal funding through efficiencies or added State revenues, or reduce benefits and services to millions of low-income Americans.

FUNCTION 500: EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES
(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
ELEMENTARY, SECONDARY AND VOCATIONAL EDUCATION (501)												
Compensatory Education....	3.70	4.20	3.55	3.60	3.55	2.95	3.75	3.55	3.55	3.55	3.70	3.55
Block Grant/Special Programs.....	0.75	0.55	0.70	0.70	0.65	0.65	0.70	0.70	0.70	0.70	0.70	0.60
Handicapped Education.....	1.30	1.00	1.35	1.30	1.30	1.50	1.45	1.35	1.35	1.35	1.30	1.25
Vocational and Adult Education.....	0.95	0.65	0.90	0.90	0.70	1.00	0.95	0.90	0.90	0.90	0.50	0.80
Impact Aid.....	0.70	0.65	0.65	0.65	0.65	0.70	0.70	0.70	0.65	0.65	0.55	0.60
Indian Education.....	0.35	0.40	0.30	0.35	0.30	0.35	0.35	0.35	0.30	0.30	0.35	0.30
Bilingual Education.....	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
Other.....	0.05	0.05	*	0.05	0.05	0.05	*	0.05	*	*	*	0.10
Subtotal, 501.....	7.95	7.65	7.60	7.70	7.35	7.35	8.05	7.75	7.60	7.60	7.25	7.35
HIGHER EDUCATION (502)												
Student Financial Assistance.....	5.15	4.15	4.70	4.75	4.20	5.00	4.95	4.75	4.70	4.60	3.80	4.25
Guaranteed Student Loans..	3.80	3.55	3.30	3.40	3.35	3.30	3.35	3.30	3.35	3.30	3.45	3.40
-- Proposed Legislation...	...	...	...	...	...	-0.05	...	...	...	...	-1.10	-0.85
Higher Education Programs.....	0.50	0.40	0.45	0.45	0.25	0.45	0.50	0.45	0.45	0.45	0.25	0.30
Gallaudet/Howard/NTID.....	0.25	0.25	0.25	0.25	0.20	0.30	0.25	0.25	0.25	0.25	0.25	0.25
Net Receipts/Collections..	0.05	-0.15	-0.05	-0.10	0.10	-0.05	-0.05	-0.10	-0.05	-0.10	0.10	-0.55
Subtotal, 502.....	9.75	8.20	8.65	8.75	8.10	8.95	9.00	8.65	8.70	8.50	6.75	6.80
RESEARCH AND GENERAL ED.....	1.20	1.10	1.30	1.35	1.10	1.25	1.40	1.35	1.30	1.30	1.10	1.20
SUBTOTAL, ALL EDUCATION...	18.90	16.95	17.60	17.80	16.55	17.55	18.45	17.70	17.60	17.40	15.10	15.35

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
TRAINING AND EMPLOYMENT (504)												
Job Training Partnership	3.80	3.40	3.35	3.70	3.00	3.65	3.55	3.35	3.35	3.35	2.90	3.10
Work Incentive (WIN)	0.25	0.30	0.20	0.20	0.15	0.20	0.20	0.20	0.20	0.20	...	0.05
Older Workers	0.35	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Employment Service	1.00	0.90	0.95	1.00	0.95	1.00	1.00	1.00	0.95	0.95	0.95	0.95
Other	*	0.05	0.10	0.10	0.10	0.05	0.10	0.10	0.10	0.10	0.10	0.05
Subtotal, 504	5.40	4.95	4.90	5.30	4.50	5.20	5.15	4.95	4.90	4.90	4.25	4.45
OTHER LABOR SERVICES	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70
SOCIAL SERVICES (506)												
Title XX	2.75	2.75	2.60	2.60	2.60	2.60	2.70	2.70	2.70	2.70	2.70	2.70
Vocational Rehabilitation	1.25	0.80	1.30	1.15	1.25	1.45	1.35	1.35	1.30	1.30	1.25	1.20
Human Development Services	2.00	1.90	1.95	1.95	1.90	1.90	2.05	2.00	1.95	1.95	2.00	1.95
Community Services Block Grant	0.35	0.40	0.35	0.35	0.15	0.25	0.35	0.35	0.35	0.35	*	0.05
Other	0.95	0.90	0.90	0.95	1.00	1.00	1.00	1.00	0.90	0.90	0.95	1.00
Subtotal, 506	7.30	6.75	7.10	7.00	6.90	7.20	7.45	7.40	7.20	7.20	6.90	6.90
FUNCTION TOTALS	32.35	29.35	30.25	30.75	28.60	30.65	31.75	30.75	30.40	30.20	26.95	27.45

* Less than $25 million.

FUNCTION 550: HEALTH

(In billions of dollars)

	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Medicaid-Current Law	21.85	22.65	24.45	24.45	24.45	24.70	26.45	26.45	26.45	26.45	25.90	25.90
Legislative Savings	...	...	...	...	...	...	...	...	...	...	-1.15	-1.15
Medicaid	21.85	22.65	24.45	24.45	24.45	24.70	26.45	26.45	26.45	26.45	24.70	24.70
Other Health Services	4.60	4.35	4.75	4.55	4.00	3.90	5.15	4.85	4.75	4.55	4.15	3.65
Health Research	5.40	4.90	5.55	5.55	5.45	5.50	5.80	5.60	5.55	5.55	5.35	5.45
Health Education and Training	0.55	0.45	0.50	0.55	0.35	0.45	0.55	0.50	0.50	0.55	0.30	0.35
Occupational Safety and Health	1.20	1.20	1.15	1.15	1.15	1.15	1.15	1.20	1.15	1.15	0.85	0.85
TOTAL	33.60	33.55	36.40	36.25	35.35	35.65	39.10	38.55	38.40	38.25	35.35	35.00

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 570: MEDICARE

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	71.70	86.65	82.25	89.75	98.15
Outlays	65.80	68.65	70.25	76.05	83.00
CBO BASELINE (Preliminary)					
Budget Authority	71.70	86.60	82.95	91.05	100.80
Outlays	65.80	69.15	76.85	86.05	96.50
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	+0.05	-0.70	-1.30	-2.65
Outlays	...	-0.50	-6.60	-10.00	-13.50

HIGHLIGHTS

The function includes funding for the medicare programs, Hospital Insurance (HI) and Supplementary Medical Insurance (SMI). These programs are authorized under the Social Security Act. (The Social Security Amendments of 1983 provide that HI will move off-budget beginning in 1992. SMI will continue to be included in the unified budget after 1992.)

The programs included in this function are designed to help finance health care for 31 million elderly and disabled persons.

President Reagan's 1987 funding estimate of $70.25 billion in outlays for the function is an increase of $1.60 billion, 2.3 percent, over the President's 1986 outlay estimates of $68.65 billion. The budget authority of $82.25 billion is 5 percent less than the 1985 budget authority of $86.65 billion.

The 1986 outlay increase primarily represents the impact of additional beneficiaries becoming eligible for coverage and the higher cost of medical care. These increased costs are more than offset by proposed regulatory and legislative changes which will reduce the deficit more than $4.7 billion in 1987 and $23 billion over 1987-1990. The reduction in 1987 budget authority reflects the final payment of $10.6 billion in funds borrowed from the hospital insurance fund by the old-age and

survivors' insurance fund in 1982. The reduction is partially offset by additional revenues to the trust fund. The differences between the President's budget request and the preliminary CBO baseline reflect differing economic assumptions and the fact that the preliminary CBO baseline does not assume any regulatory or legislative changes.

Highlights for the major programs in the function are as follows:

Hospital Insurance (HI) - The program is financed through payroll tax contributions which are reflected as budget authority. The budget proposes $62.70 billion in budget authority and $49.95 in outlays for HI in 1987, an increase of $0.75 billion in outlays over the 1986 level of $49.20 billion. The rate of increase in national hospital costs, which are 90 percent of HI spending, now is 5 percent, down significantly from the 15 percent level of 1981. The slower rate results from the hospital cost restraints imposed under the prospective payment system (PPS), the Omnibus Budget Reconciliation Act (OBRA), and the Tax Equity and Fiscal Responsibility Act (TEFRA), in addition to other cost restraints initiated by the public and private sectors.

The President's Budget proposes HI legislative and regulatory reductions totalling $2.75 billion in 1987 to further restrain growth in medicare hospital and related services. Among the reductions are the following:

-- Hospital capital costs will be incorporated in the diagnosis-related group (DRG) payments, saving $0.45 billion in 1987.

-- Direct medical education payments to hospitals will be reduced by $0.50 billion in 1987.

-- Indirect medical education payments will be reduced by one-half, saving $1.1 billion in 1987.

-- Medicare working elderly provisions (also affects SMI) will be extended to persons over 69 years of age. This will save $0.40 billion in 1987 and make medicare the secondary payor after employer-sponsored health insurance coverage.

-- Home health copayments will be reduced by $0.10 billion in 1987.

Supplementary Medical Insurance (SMI). One fourth of program costs are financed through beneficiary premiums and the remainder by general funds. For 1987, the budget proposes $26.85 billion in budget authority and $27.60 billion in outlays. This is $2.35 billion in outlays above the 1986 estimate. The 1987 request includes SMI outlay reductions of $1.2, billion which will be achieved through legislative and regulatory actions.

While SMI costs also have slowed compared to historical trends, they continue to increase in the double digits. For example, the budget projects that under current law, physician reimbursements, 70 percent of SMI spending, are expected to increase by 12 percent in 1987 over 1986. The SMI reductions proposed to offset the increases include the following:

-- Medicare physician reimbursements will be limited for selected procedure and the calculation of the inflation index will be changed. Savings of $0.45 billion will be achieved in 1987.

-- Payments for end-stage renal disease will be limited to save $0.10 billion in 1987.

-- Reimbursements for laboratory fees will be limited to save $0.05 billion in 1987.

-- Medicare coverage for new beneficiaries (also affects HI) will be delay by one month to save $0.10 billion in 1987.

-- The medicare Part B deductible will be increased from $75 to $100 per year in 1987, which will save $0.30 billion.

Medicare Premiums -- Medicare premiums, which now cover 25 percent of program cost, will be increased to 27 percent in 1987 and to 35 percent by 1991 for individuals who pay their own premiums. For States that pay medicare premiums for elderly medicaid recipients and other third party payors, the share to be covered by premiums will increase to 50 percent of program cost by 1991. The premium changes will increase income to the SMI trust fund by $0.75 billion in 1987.

MAJOR ISSUES

1. Hospital Insurance (HI)

The $49.95 billion requested for HI is 1.5 percent above the 1986 spending estimate of $49.20 billion. Included in the request are reductions of $2.75 billion in 1987 outlays. Without the reductions, program spending would increa by 7 percent. Hospital costs are the major component of HI spending and the 1. percent increase in HI reflects cost restraints which have helped to slow the rate of increase in hospital costs. The 1983 Social Security Amendments includ a medicare prospective payment system (PPS) which the budget assumes will be fully in place for the first time in 1987.

The $2.75 billion in HI savings proposed in the budget includes both regulatory and legislative changes. The major proposals are as follows:

-- Include capital costs in the DRG payment (1987 savings: $0.45 billion). In enacting the PPS in 1983, hospital capital costs were excluded. Instead, capital costs continued to be reimbursed under the old medicar payment system which allowed hospital capital expenses to be passed through. The budget proposal would save $0.45 million in 1987 by beginning to phase in such payments under the DRG system. These paymen would be fully phased in by 1991.

-- Reform direct medical education payments (1987 savings: $0.50 billion). Th PPS legislation of 1983 provided for separate reimbursement of direc medical education costs, in other words the costs of paying stipends an clinical training for hospital residents and interns and education cost for allied health professionals and nurses. Payments for allied health professionals and nurses are proposed to be eliminated on the grounds that there is no shortage of such professionals. Payments for

residents and interns will be continued, but such payments will be restructured to cover only services and no education costs.

-- Reduce indirect medical education payments by one-half (1987 savings: $1.1 billion). The indirect medical education payment covers the additional service costs incurred by teaching hospitals, such as more severely ill caseloads and additional medical procedures ordered by residents and interns. Congress doubled the payment rate in 1983 compared to what it previously had been. The grounds for increasing the rate was that teaching hospitals also care for more low-income patients for whom hospitals have to absorb the cost of care. This indigent care is not otherwise reimbursed by medicare.

-- Extend the working elderly provisions to medicare beneficiaries over 69 years of age (1987 savings: $0.40 billion in HI and $0.15 billion in SMI). The budget assumes that health care bills will be paid first by employer-sponsored insurance plans where they exist for medicare beneficiaries over 69 years of age and for the spouses of such beneficiaries. Medicare will pay only the residual amount in such instances. This provision to make medicare a secondary payor already is in effect for beneficiaries who are 69 years of age or younger.

-- Impose a copayment for medicare home health services (1987 savings: $0.10 billion). Beneficiaries would be required to pay a copayment for home health care up to the first 100 visits unless they have been inpatients in a hospital or nursing home immediately prior to receiving such home health service. The copayment rate would equal one percent of the inpatient hospital deductible, or approximately $5.00 per visit.

2. Supplementary Medical Insurance (SMI)

The President's budget request of $27.60 billion in SMI outlays is an increase of 9.3 prcent over the 1986 outlay estimate of $25.25 billion. The 1987 billion request assumes legislative and administrative changes which will reduce the deficit by $1.2 billion. Without these changes, SMI spending would have increased by 14.1 percent.

Physician payments are 70 percent of SMI costs. A freeze on such payment rates has been in effect since July 1984 and is scheduled to end on March 15, 1986. Despite the freeze, medicare physician payments would increase by 12 percent in 1987 over 1986 under current law projections according to the Department of Health and Human Services. The increase largely reflects increased utilization. The President's budget proposes to limit the physician reimbursement and other increases through a number of program reductions, including the following:

-- Reform physician reimbursements (1987 savings: $0.45 billion). The formula for updating physician reimbursements to allow inflation would be revised to eliminate overcompensation. A similar change already has been made in the calculation of the consumer price index. In addition, new guidelines and payment restraints would be established for a number of

procedures, such as cataract surgery, for which physicians currently are believed to be overcompensated.

-- Increase the medicare deductible (1987 savings: $0.30 billion). Increase the annual deductible from $75 to $100 in 1987. In future years, the deductible would increase automatically at the same rate as medicare physician payments.

-- Update payments for end-stage renal dialysis -- ESRD -- (1987 savings $0.10 billion). Physician and facility fees for outpatient renal dialysis treatment have not been fully updated since 1983. More current and refined data now exist for determining such reimbursements. If applied, such data would result in lower payments. The President's budget proposes to update the payments and reduce them.

-- Delay medicare eligibility (1987 savings: $0.10 billion in SMI and $0.20 billion in HI). The budget proposes to delay medicare eligibility until the first full month in which an individual turns 65 years of age.

-- Limit clinical laboratory payments (1987 savings: $0.05 billion). The budget proposes to freeze laboratory payments for one year.

3. Medicare Part B Premiums

The President's budget proposes to save $0.75 billion in 1987 by increasing Part B (SMI) premiums. Currently, premiums cover 25 percent of program costs and the remaining 75 percent is paid by general funds. The budget proposes to increase the premium to cover 35 percent of program costs for individuals who pay their own premiums and 50 percent for States (paying for medicaid recipients) and other third party payors. The increases would be phased in over five years. For 1987, the annual premiums for an individual would be $224.00 compared to the 1986 cost of $214.00.

PERSPECTIVE

Medicare pays 28 percent of national hospital expenses and 19 percent of physician costs. In addition, medicare pays for home health, hospice, nursing home care, durable medical equipment and some other medical services.

In 1987, the President's budget requests $70.25 billion for medicare. This represents 7.1 percent of total outlays in the President's request for Federal spending. Compared to 1986, total program spending is projected to increase by 2.3 percent over the prior year outlays of $68.65 billion. The 1987 outlay estimate includes the impact of legislative and regulatory changes which will reduce the deficit $4.7 billion. Without these reforms, medicare would increase by 9.2 percent in 1987.

Medicare and other public and private health care continue to reflect a very significant proportion of national spending. Total health spending represented 10.6 percent of the gross national product (GNP) in 1984. However, the rate of increase is beginning to slow. In 1983 health care was 10.7 percent of GNP. Even more revealing is the fact that health care costs in 1984 increased by 9.1 percent, the smallest rate of increase for health care expenditures in 19 years.

FUNCTION 570: MEDICARE

(In billions of dollars)

	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Program												
Hospital Insurance	52.75	48.65	67.30	49.35	67.35	49.20	62.30	54.20	62.30	51.90	62.70	49.95
Supplemental Medical Insurance	24.55	22.75	25.05	25.60	24.95	25.25	27.10	29.15	26.30	28.35	26.80	27.60
Premiums and Collections	-5.55	-5.55	-5.80	-5.80	-5.75	-5.75	-6.50	-6.50	-5.75	-5.75	-7.30	-7.30
Proposed Legislative and Regulatory Savings	...	...	...	...	...	...	...	...	(-0.10)	(-2.35)	(-1.80)	(-4.70)
TOTAL	71.70	65.80	86.60	69.15	86.65	68.65	82.95	76.85	82.85	74.50	82.25	70.25

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 600: Income Security

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	164.10	151.45	153.30	163.35	166.05
Outlays	128.20	118.10	118.35	123.10	125.75
CBO BASELINE (Preliminary)					
Budget Authority	164.10	156.55	163.95	172.25	176.55
Outlays	128.10	119.40	123.70	130.95	135.50
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-5.10	-10.65	-8.90	-10.50
Outlays	...	-1.30	-5.35	-7.85	-9.75

HIGHLIGHTS

Programs in the Income Security function provide cash and in-kind benefits to people who need temporary or permanent income assistance. Assisted groups include: retirees, disabled, unemployed, children, or low-income persons.

Following are highlights of the 1987 budget:

- General Retirement and Disabilty Programs -- The budget provides outlays of $5.45 billion for general retirement and disability programs other than social security and Federal employee retirement, a decrease of $0.25 billion below the fiscal year 1987 preliminary CBO baseline level. The budget assumes enactment of a freeze on cost-of-living adjustments (COLA) in fiscal year 1987 for the private pension component of the railroad retirement program and industry financing of 25 percent of the cost of the dual benefit that goes to certain railroad retirees who are also eligible for social security. The budget also assumes the resubmittal of previous proposals to increase the premiums paid by employers to the Pension Benefit Guaranty Corporation and to increase the coal tonnage tax which finances a portion of the benefits in the black lung program.

- Federal Employee Retirement and Disability Programs -- The budget provides outlays of $42.45 billion for Federal employee retirement and disability programs, a decrease of $0.80 billion below the fiscal year 1987 preliminary

CBO baseline level. The budget proposes to continue the freeze on cost-of-living adjustments (COLA's) for military and civilian retirees which was imposed this year by the sequestration process mandated by the Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177). In addition, the reductions assume enactment of a number of structural changes to the Federal civilian program similar to ones transmitted by the Reagan administration in previous budgets, including: an increase in the retirement age for retirees, basing annuity amounts on a longer period of service, reducing COLA's after fiscal year 1987 by two percentage points below the increase in the Consumer Price Index (CPI) and terminating student benefits. Finally, the budget proposes to increase the contribution for retirement which Federal civilian workers pay. The budget proposes one structural change to the military retirement system. This change would be to base the initial retirement benefit for service members who entered military service after September 1980 on the highest three years of basic pay rather than their final basic pay.

- Unemployment Compensation -- The budget provides outlays of $16.90 billion for unemployment compensation, which is $0.15 billion above the fiscal year 1987 preliminary CBO baseline. The budget again proposes the extension of the unemployment compensation system to railroad workers who are currently covered under a separate system.

- Food and Nutrition Programs -- The budget provides outlays of $18.15 billion for food and nutrition programs, a decrease of $1.55 billion below the preliminary CBO baseline level for fiscal year 1987. The reductions include: elimination of the subsidy provided to non-needy children under the school breakfast and lunch programs, imposition of a means-test in the child care food program, and food stamp savings from proposals to reduce reimbursement for administrative costs and to require States that pay for all erroneous payments in excess of five percent.

- Subsidized Housing -- The budget provides budget authority of $3.00 billion and outlays of $12.25 billion for subsidized housing programs, a decrease of $9.75 billion in budget authority and $1.75 billion in outlays below the preliminary CBO baseline level for fiscal year 1987.

- Other Income Security Programs -- The budget provides outlays of $23.30 billion for other income security programs, a decrease of $1.30 billion below the preliminary CBO baseline level for fiscal year 1987. The reductions include the resubmission of several AFDC benefit reductions which the Congress rejected in prior years and a proposal to reduce reimbursement for administrative expenses. The budget also proposes to fund all refugee cash and medical assistance through the refugee assistance appropriation and also to require States to assume a greater share of the cost of this program.

MAJOR ISSUES

1. Changes to Entitlement Programs

The budget proposes savings in entitlement and associated benefit programs of $1.70 billion in outlays in fiscal year 1987 below the OMB estimates of what would

be required to continue current law. The most significant proposed changes are described in these highlights (For trust funds in which the budget authority comes in part from revenues, the budgetary impact of the budget proposals is expressed in terms of outlays. For appropriated entitlements, the budgetary impact is expressed in terms of both budget authority and outlays.)

- Child Nutrition

  The budget proposes to save $0.80 billion in budget authority and $0.70 billion in outlays in fiscal year 1987 and $2.55 billion in budget authority and outlays over fiscal years 1987-1989. The major source of these savings are assumed from the resubmission of the proposal in the fiscal year 1986 budget to eliminate the meal subsidy for non-needy children in the school lunch program. In 1981, the administration proposed to eliminate this subsidy. Instead, Congress reduced the subsidy by about one third. The General Accounting Office estimated that the 1981 reductions caused student participation to decline 3.9 million.

  In recommending to the Budget Committee last year that this same proposal not be assumed in the First Budget Resolution for Fiscal Year 1986, the Committee on Education and Labor cited an analysis prepared by the Congressional Research Service that 17,900 schools with 5.5 million children who participate in school meal programs, could drop out of the program as a result of this cut. These are schools with 20 percent or less needy children. To the extent that schools elected to drop the program, all children would lose nutrition assistance.

  The budget again proposes to impose a means test on the child care food program. Funding for the child care program would decline by $145 million to $338 million in fiscal year 1987. The subsidies to purchase food provide the bulk of Federal support for residential day care. Residential day care providers who participate in the program also become subject to State and local health, sanitation, and building code regulations. Opponents of the budget proposal argue that this change would cause many more residential day care centers to be unregulated.

- Aid to Families with Dependent Children (AFDC)

  The budget proposes to save $0.20 billion in budget authority and outlays in fiscal year 1987, and $0.75 billion in budget authority and outlays over fiscal years 1987-1989 through three benefit changes to the AFDC program. Each of these proposals is either identical or similar to previous administration proposals which the Congress did not approve. The proposals include:

  -- AFDC benefits would be denied to parents who are legal minors if they establish a household separate from their parents. This would result in the denial of benefits to about 10,000 persons.

  -- AFDC benefits would be denied to a relative caring for children in a AFDC household when the youngest child reaches age 16. The only exception would be if the adult was unable to work because of disability. This would result in a denial of benefits to about 85,000 persons.

-- All employable adult AFDC applicants would be required to participate in job search activities and all employable recipients would have to participate in both job search and work activities. The work activities could include: community work experience programs in which recipients would work off their benefits or on-the-job training. States would be required to implement these changes within three years. The budget assumes net savings of $52 million in fiscal year 1987 from this proposal, including Federal benefit savings of $252 million which would be offset in part by increased Federal matching or State administrative costs of $200 million.

- Food Stamps

The budget proposes to save $0.30 billion in budget authority and outlays in fiscal year 1986 and $1.3 billion in budget authority and outlays through fiscal year 1989 through changes which parallel what is proposed for mandatory job search and work requirement in AFDC. The largest source of the savings is the proposed repeal before they go into effect of some benefit restorations which were enacted in the Food Security Act of 1985. These were partial restorations of 1981-2 benefit reductions and an increase in the asset limit from $1,500 to $2,000. The asset increase was less than the increase proposed in 1984 by President Reagan's Task Force on Food Assistance. The restorations and the increase in the asset limit were assumed in the First Budget Resolution for Fiscal Year 1986. Finally, included in these totals are savings attributable to changed procedures for reimbursement to States for administrative costs and fiscal sanctions against States. These fiscal sanctions and administrative reimbursement changes are described in the following section.

- Welfare Program Administration and Fiscal Sanctions

The Reagan budget proposes to phase in a uniform 50 percent Federal matching rate for administrative and training costs in means-tested assistance programs, including food stamps, child support enforcement, and AFDC which are included in the Income Security function, and medicaid, which is discussed in the Major Issues section of Function 550: Health. For States in which the per recipient administrative costs exceed a ceiling equal to 175 percent of the national median, the matching rate would be reduced to 25 percent for the amount above that ceiling. The reimbursement rate for ADP acquisition would be reduced in stages from 90 percent to 50 percent. The proposed changes would save $17 million in fiscal year 1987 in the AFDC and child support enforcement program. The budget documents do not specify the savings in the food stamp program.

The budget also notes that fiscal sanctions will be imposed in the AFDC program in fiscal year 1987, but the budget documents do not specify the amount. The conference agreement on the Consolidated Omnibus Budget Reconciliation Act of 1985 (H.R. 3128) included a Senate provision for a two-year moratorium on the collection of fiscal sanctions while procedures to improve administration and also to collect better data on the extent of erroneous payments were developed.

The budget proposes that starting in fiscal year 1987, States be held liable for the full dollar value of any erroneous food stamp program in excess of a 5 percent error rate. The budget documents do not specify the amount of savings from this sanction.

- Federal Employee Retirement

The budget proposes to save $1.15 billion in outlays in fiscal year 1987 an $5.95 billion in outlays over fiscal years 1987-1989 through the following changes to the Federal civilian and military retirement system.

-- Military and Civilian Retirement COLA Freeze -- The budget proposes a one year COLA freeze for both military and civilian employee retiremen This would continue the COLA freeze for fiscal year 1986 imposed by P. 99-177.

-- Future civilian retirement annuities would be based on the highest average salary for five years. Under current law, three years are use to calculate average salary.

-- The retirement age for full benefits would be increased to age 62. Wh this proposal was fully implemented in four years, a worker who retire at age 55 would have a benefit reduction of 14 percent. A worker with 20 years of service who elected early retirement at age 50 because of reduction in force would experience a benefit cut of 24 percent in comparison with the 10 percent reduction which would be imposed under current law.

-- Student benefits for children of deceased or disabled Federal civilian workers would be terminated. This parallels the change made in 1981 f social security.

-- The final structural change proposed for the Federal civil service retirement program is a two percentage point increase in contributions from 7 to 9 percent for Federal workers in the Executive Branch. The budgetary impact from this proposal in fiscal year 1987 is $0.9 billio and is shown as revenue with an associated increase in budget authorit into the trust fund.

-- The budget proposes one structural change to the military retirement program. This change would base the initial retirement benefit for service members who entered military service after September 1980 on t highest three years of basic pay rather than their final basic pay. Essentially, this proposal would substitute for military retirement th high-three calculation which the administration wants changed in civil service retirement on the grounds that it is too generous in compariso with the private sector. The budget documents do not indicate that th permanent COLA reduction after fiscal year 1987 which would apply to Federal civilian retirees would also apply to retired military personnel.

-- The Postal Service, and the District of Columbia would be required to phase in the paying of the full cost of employee pensions less the employee's contributions, and Federal retirement, life, and health insurance coverage for employees first hired by the District of Columb after September 30, 1987, would be discontinued. In addition, the Railroad Retirement Board would be required starting in fiscal year 19 to pay the full cost of employee pensions, less the employee's contributions. Unlike the proposals for the District of Columbia and

the Postal Service, there would be no phase-in of the increased contribution.

- Railroad Retirement

The net deficit reduction proposed by the budget in fiscal year 1986 for the railroad retirement program is $0.10 billion. This is the net impact of three proposals.

-- The budget proposes to continue for a second year the COLA freeze in the private pension equivalent of the railroad retirement benefit which was mandated by P.L. 99-177 for fiscal year 1986.

-- The budget proposes that the rail industry finance 25 percent of the cost of the dual benefit which goes to railroad retirees who are also vested under the social security system. The budgetary impact from this proposal in fiscal year 1987 is $0.1 billion and is shown as revenue with an associated increase in budget authority into the trust fund.

-- The budget again proposes the extension of the Federal-State unemployment compensation program to railroad workers who are currently covered under a separt seystem. In the 1985 reconciliation conference agreement, both the House and Senate approved provisions to continue the existing railroad unemployment system, while ensuring that the outstanding loan from the railroad retirement fund to the railroad unemployment insurance fund is repaid.

-- The budget proposes the privatization of the railroad retirement system, but reflects no savings in the budget from this proposal.

2. Changes in Discretionary Program Levels

The budget proposes to reduce several discretionary programs well below the current level. These reductions include:

- Subsidized Housing

Major reductions are proposed in the housing programs primarily from reductions in the program level for HUD assisted housing, including section 8 and public housing. The overall funding for the subsidized housing programs would be $3.00 billion in budget authority and $12.25 billion in outlays in fiscal year 1987, which is a reduction of $9.70 billion in budget authority and $1.70 billion in outlays below the preliminary CBO baseline. These reductions would be in the following programs:

-- Assisted Housing Units -- The budget proposes to fund 50,000 units through housing vouchers which the Reagan administration proposed in fiscal year 1986 to replace the subsidies under the section 8 existing housing program. These units would be financed by deferring $2.3 billion in budget authority from fiscal year 1986 into fiscal year 1987. For fiscal year 1986, Congress appropriated funds for 97,000 units, including 36,000 vouchers, 32,000 existing section 8 contracts, and the remainder from other assisted housing programs. The budget proposes to rescind $4.4 billion in budget authority in fiscal year 1986. No new

public housing or Indian housing units are proposed for commitment in fiscal year 1987. During the current fiscal year, 350 units of public housing units will be reserved. The budget documents state that these reservations are being made to satisfy a court order.

-- Freeze on Reimbursement for Rent Increases -- The budget proposes that the rents on which housing subsidies are based be frozen in fiscal year 1987. This means that low-income families currently getting section B assistance or housing vouchers will have to pay from their own pockets, all of the customary annual increases imposed by landlords. For many of these families, rents would be raised above the current legal limit of 30 percent of income.

-- Tenant Income Verification -- Outlay savings of $77 million in fiscal yar 1987 are assumed from requiring the release of social security or employer identification numbers to HUD or other administering agencies to use in tenant income verification.

-- Public Housing Operating Subsidy -- The budget proposes funding of $1.15 billion in budget authority and $1.35 billion in outlays, a reduction of 14 percent below the preliminary CBO baseline estimate. The budget documents indicate that no growth in personnel or related expenses is proposed for the public and Indian housing authorities which receive these funds to offset operating costs for public housing.

-- Rural Housing Assistance -- The budget proposes to terminate the separate Farmers Home Administration (FmHA) housing assistance programs. The savings in this function from this proposal are $50 million in budget authority and $15 million in outlays. The primary impact of this proposal is in Function 370: Commerce and Housing Credit.

-- Public Housing Financing -- The budget proposes to finance assisted housing through direct financing by the Department of Housing and Urban Development rather than to rely on private credit markets. The direct financing proposal is similar to what was approved last year in the conference on the Consolidated Omnibus Budget Reconciliation Act of 1985 (H.R. 3128). The fiscal year 1987 outlay savings in Function 600: Income Security are $1.30 billion. The increased cost in Function 900: Net Interest from this proposal is $1.20.

PERSPECTIVE

The President's funding request for income security programs in 1987 is less than preliminary CBO baseline estimates and projections for every year through fiscal year 1991. The total difference over the period 1987-1991 is $52.5 billion in outlays. Food and nutrition programs which serve primarily women and young children would receive $11.50 billion less over the 1986-1991 period under the budget policies. Funding for low income housing would be $20.20 billion less under the budget proposal than the preliminary CBO baseline estimate. Federal employee retirement programs would be $12.25 billion below the preliminary CBO baseline estimate. Overall differences are shown in the table below:

Comparison of Preliminary CBO Baseline Outlays and President's Request

(In billions of dollars)

	1986	1987	1988	1989	1990	1991
CBO Baseline (Preliminary)...	119.40	123.70	130.95	135.50	140.60	148.50
President's Budget..	118.10	118.35	123.10	125.75	128.35	132.45
President Over(+)/ Under(-) CBO Baseline (Preliminary)...	-1.30	-5.35	-7.85	-9.75	-12.25	-16.05

FUNCTION 600: INCOME SECURITY

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline ((Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Railroad Retirement	5.15	3.50	5.80	3.85	5.60	3.80	5.20	3.90	5.20	3.80	4.75	3.75
Proposed Legislation											0.15	0.05
Black Lung	1.70	1.95	2.00	1.95	1.70	1.65	2.00	2.00	2.00	1.95	1.55	1.65
Proposed Legislation												
Pension Benefit Guaranty Corp	...	...	...	0.05	...	0.05	...	0.05	...	0.05	...	0.10
Proposed Legislation						-0.20						-0.20
Other	-0.25	0.00	-0.20	-0.25	0.10	0.05	-0.25	-0.25	-0.25	-0.25	0.10	0.10
Subtotal, 601	6.55	5.45	7.50	5.60	7.40	5.35	6.90	5.70	6.95	5.55	6.55	5.45
Civil Service Retirement	40.20	23.10	41.85	23.95	41.85	24.05	43.40	25.20	43.40	24.55	43.25	25.40
Proposed Legislation											2.05	-0.65
Military Retirement	27.45	15.80	31.25	17.60	30.95	17.65	33.85	18.35	33.85	17.90	33.70	18.50
Proposed Legislation											.25	-0.50
Foreign Service Retirement	0.70	0.20	0.75	0.25	0.75	0.25	0.80	0.25	0.80	0.25	0.80	0.25
Proposed Legislation											-0.15	*
Life Insurance	...	-0.65	0.00	-0.70	...	-0.75	0.00	-0.70	0.00	-0.70	...	-0.80
Federal Workers Compensation	0.20	0.20	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Proposed Legislation												
Other	-*	-0.05	-0.05	-0.05	-0.25	-0.05	-0.05	-0.05	-0.05	-0.05	-0.25	-0.05
Subtotal, 602	68.50	38.60	74.05	41.30	73.80	41.40	78.25	43.30	78.25	42.20	80.00	42.45
Unemployment Compensation	21.00	17.45	20.85	16.45	21.10	16.50	22.15	16.75	22.15	16.55	22.20	16.90
Proposed Legislation											0.10	*
Subtotal, 603	21.00	17.45	20.85	16.45	21.10	16.50	22.15	16.75	22.15	16.55	22.20	16.90

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Subsidized Housing	10.75	9.90	8.55	10.40	5.10	10.65	9.75	10.85	8.55	10.85	...	10.65
Proposed Legislation						-0.70						-1.70
Public Housing Operating Subsidies	1.40	1.20	1.40	1.35	1.15	1.35	1.35	1.40	1.30	1.35	1.15	1.30
Proposed Legislation												
Low Rent Public Housing	14.55	13.90	1.30	1.45	1.25	1.40	1.45	1.60	1.46	1.60	1.35	1.50
Proposed Legislation					-0.50	-0.50					0.35	0.35
Other	0.15	0.20	0.15	0.15	0.15	0.20	0.15	0.15	0.15	0.15	0.10	0.15
Subtotal, 604	26.90	25.20	11.40	13.30	7.20	12.35	12.70	14.00	11.45	13.95	3.00	12.25
Food Stamps	12.60	12.55	12.60	12.65	12.65	12.55	13.05	13.05	12.65	12.60	12.65	12.65
Proposed Legislation					-0.05	-0.05					-0.30	-0.30
Child Nutrition	3.80	3.65	4.10	3.90	3.90	3.90	4.00	4.15	4.00	4.15	4.25	4.20
Proposed Legislation											-0.80	-0.70
WIC	1.55	1.55	1.60	1.60	1.55	1.60	1.65	1.65	1.60	1.60	1.60	1.65
Other	0.75	0.80	0.70	0.75	0.75	0.80	0.75	0.75	0.70	0.75	0.75	0.60
Subtotal, 605	18.65	18.55	19.00	18.90	18.75	18.75	19.45	19.60	18.95	19.10	18.15	18.10

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
AFDC.....	8.55	8.65	9.10	9.10	9.00	9.05	9.50	9.50	9.50	9.50	8.45	8.45
Proposed Legislation....											-0.25	-0.25
Child Support Enforcement..	0.65	0.60	0.60	0.65	0.60	0.65	0.75	0.75	0.60	0.65	0.75	0.75
Proposed Legislation....											-0.05	-0.05
Supplemental Security Income.....	9.45	9.60	10.15	10.20	9.90	10.15	10.40	10.40	10.15	10.15	10.55	10.55
Proposed Legislation....											-0.05	-0.05
Low-Income Energy Assistance.....	2.10	2.15	2.00	2.00	2.00	2.00	1.90	1.95	1.80	1.85	2.10	2.10
Proposed Legislation....												
Earned Income Tax Credit...	1.10	1.10	1.30	1.30	1.30	1.30			1.25	1.25	1.25	1.25
Refugee Assistance.....	0.45	0.45	0.40	0.45	0.30	0.40	0.40	0.40	0.40	0.40	0.35	0.40
Other.....	0.20	0.20	0.20	0.20	0.15	0.15	0.20	0.20	0.20	0.20	0.15	0.10
Subtotal, 609.....	22.50	22.75	23.75	23.90	23.25	23.75	24.40	24.45	23.90	24.00	23.30	23.30
TOTAL, FUNCTION 600.....	164.10	128.20	156.55	119.40	151.45	118.10	163.95	123.70	161.55	121.35	153.30	118.35

* Less than $25 million.

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 650: SOCIAL SECURITY

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority.....	199.50	199.40	227.85	259.25	283.75
Outlays.....	188.60	200.05	212.20	226.05	239.95
CBO BASELINE (Preliminary)					
Budget Authority.....	199.50	199.50	226.55	256.65	280.80
Outlays.....	188.60	199.40	211.40	226.15	241.50
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority.....	...	-0.10	+1.30	+2.60	+2.95
Outlays.....	...	+0.65	+0.80	-0.10	-1.55

HIGHLIGHTS

The function includes budget for the old-aged, survivors' and disability insurance (OASDI) programs. The Deficit Reduction Amendments of 1985 (The Gramm-Rudman Act) provides for these social security cash assistance programs to be taken off budget beginning in fiscal year 1986.

The programs included in Function 650 are designed to provide monthly cash benefits to 38 million retired and disabled workers and their dependents.

President Reagan's 1987 budget estimate of $212.20 billion in outlays for the function is an increase of $12.15 billion, or 6 percent, over the President's 1986 outlay estimates of $200.05 billion. The budget authority of $227.85 billion is $28.45 billion, or 14.3 percent, over the 1986 budget authority estimate. The 1987 outlay increase primarily represents the impact of 703,000 additional beneficiaries becoming eligible for coverage, higher benefit payments, and the cost of the 1987 social security COLA. The budget authority increase reflects additional payroll tax contributions. In addition, the President's Budget assumes a legislative change to accelerate trust fund deposits from States and local governments. The differences between the President's budget and the CBO preliminary CBO baseline reflect differing economic assumptions. In addition, the preliminary CBO baseline does not include any legislative changes.

Highlights for the major programs in the function are as follows:

-- The President's budget assumes a cost-of-living allowance (COLA) of 3.7 percent to be paid in January 1987.

-- As provided under the Gramm-Rudman Act, the operations of the trust funds are taken off budget beginning in 1986. However, income and outlays of the funds are considered in calculating the Federal deficit.

-- In 1987, the old-aged and survivors insurance (OASDI) trust fund will complete repayments of the balance of the $17.5 billion which was borrowed from the hospital insurance and disability insurance trust funds in 1982.

-- The social security payroll tax contribution rate for 1987 will be 7.15 percent compared to 7.05 percent in 1986. In 1987, taxes must be paid on the first $43,500 of income compared to $42,000 in 1986.

-- The President's budget continues to support legislation that accelerates collection of payroll tax contributions from State and local governments. The legislation would increase trust fund income by $0.40 billion in 1987 and by $1.90 billion over 1987-89.

MAJOR ISSUES

1. COLA

The President's budget proposes no change from current law in the awarding of the social security cost-of-living allowance. The COLA proposed is 3.7 percent for 1987, 4.3 percent for 1988, and 3.6 prcent for 1989. COLA's would be awarded in January of each year.

2. Trust Fund Interest

The Gramm-Rudman Act of 1985 requires that social security trust fund balances be made whole to compensate for interest losses in 1984 and 1985 resulting from debt ceiling restrictions in those years. The President's budget estimates that such losses total $382 million and provides for restoration of the funds.

3. Accelerated Collection of State and Local Payroll Deposits

The President's budget continues to support legislation to require State and local governments to expedite their payments to the social security trust funds by depositing their contributions on the same schedule as private employers.

PERSPECTIVE

The President's budget requests full funding for social security, including a COLA of 3.7 percent which is to be awarded in January 1986. Payments under the program, including the COLA, are awarded to approximately 94 percent of all elderly persons.

In 1983, the old-age and survivors' insurance trust fund was facing bankruptcy and had to borrow a total of $17.5 billion from the disability and hospital insurance trust funds. As a result of the Social Security Amendments of 1983, the trust funds are in greatly improved status and the balance of all borrowed monies will be repaid by the end of 1986.

FUNCTION 650: SOCIAL SECURITY

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Old-Age and Survivors' Insurance Trust Fund.....	175.65	169.30	181.35	180.15	180.30	179.70	207.10	191.00	207.10	186.40	207.70	191.20
Disability Insurance Trust Fund.....	20.55	19.30	22.40	20.30	22.30	20.35	20.15	21.10	20.15	20.60	20.20	21.05
Proposed Legislation.....	...	...	...	...	...	...	...	...	...	...	(0.40)	...
Offsetting Receipts and Interfund Transactions....	3.35	...	-4.25	-1.05	-3.20	...	-0.70	-0.70	-0.70	-0.70	...	...
TOTAL.....	199.50	188.60	199.50	199.40	199.40	200.05	226.55	211.40	226.55	206.30	227.85	212.20

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 700: VETERANS BENEFITS AND SERVICES

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	27.40	27.40	26.70	27.30	27.50
Outlays	26.35	26.60	26.40	26.90	26.90
CBO BASELINE (Preliminary)					
Budget Authority	27.40	27.40	27.70	28.25	28.45
Outlays	26.35	26.60	27.10	27.95	28.05
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	...	-1.00	-0.95	-0.95
Outlays	...	...	-0.70	-1.05	-1.15

HIGHLIGHTS

This function covers funding for programs which provide compensation payments to service-disabled veterans; pension benefits to needy wartime veterans who are aged or disabled; education and training opportunities; hospital and medical care for veterans; and veterans housing loans. President Reagan's budget proposal for fiscal year 1987 contains $26.70 billion in budget authority and $26.40 billion in outlays. The fiscal year 1987 budget authority level for this function reflects a net decrease of $1.00 billion below the preliminary CBO baseline for fiscal year 1987.

Highlights of the major programs in this function are as follows:

- Compensation -- President Reagan's 1987 budget proposes a 3.7 percent cost-of-living adjustment (COLA) in compensation payments to veterans with service-connected disabilities and their survivors, effective January 1987. The compensation COLA is estimated to cost $0.30 billion in fiscal year 1987.

- Pensions -- The budget estimates that pensions for veterans with non-service-connected disabilities and their survivors will rise by 3.7 percent in January of 1987. The increase is estimated to cost $0.10 billion in 1987.

- Burial Benefits -- The budget proposes the elimination of the $150 plot allowance to veterans except those who are compensation or pension recipients, at an estimated savings of $0.05 billion in fiscal year 1987 and $0.1 billion over three years.

- Education -- The budget proposes the elimination of the peacetime military education program and the reopening of the less costly Post-Vietnam era Veterans Educational Assistance program (VEAP). There are negligible savings in fiscal year 1987.

- Medical Care -- The budget proposes $9.10 billion in budget authority and $8.95 billion in outlays for veterans medical care in fiscal year 1987. This budget request is $0.30 billion in budget authority and $0.40 billion in outlays below the fiscal year 1987 preliminary CBO baseline. The President's fiscal year 1987 medical care budget is $0.05 billion in outlays below the fiscal year 1986 preliminary CBO baseline estimate of funding for the current year. Savings will be achieved through the imposition of a means test and reimbursement from insurance companies. Specific savings resulting from the eligibility changes are not available. The budget estimates that third-party collections will total $0.2 billion in 1987 and $0.75 billion over three years.

- Medical Facility Construction -- The budget proposes $0.45 billion in budget authority for VA medical facility construction in fiscal year 1987. This reflects a budget authority decrease of $0.20 billion below the preliminary CBO baseline for fiscal year 1986 and $0.20 billion, or 33 percent, below the preliminary CBO baseline for fiscal year 1987.

- Housing -- The budget proposes that loan origination fees on VA guaranteed and direct housing loans be increased from 1 to 2 percent of the mortgage amount in 1987 rising to 3.8 percent by 1990. Outlay savings are estimated to be $0.15 billion in 1987 and $0.50 billion over three years.

MAJOR ISSUES

1. Compensation

The budget provides $10.4 billion in budget authority to fund basic monthly cash payments to approximately 2.6 million veterans with service-related disabilities and their survivors. The budget provides $306 million in budget authority and $275 million in outlays to fund a 3.7 percent cost-of-living adjustment (COLA) in payments to all compensation beneficiaries effective January 1987. Although compensation COLAs are not indexed by law to inflation, Congress has acted each year to increase benefits. The number of compensation beneficiaries will drop by 100,000 between 1985 and 1989, but overall costs will increase due to COLA payments.

2. Hospital Operations, Medical Care, and Construction

The budget proposes $9.60 billion in budget authority and $9.70 billion in outlays for VA construction, medical care, research, and administration in fiscal year 1987. The VA health care system includes 172 hospitals, 228 outpatient clinics, and 119 nursing homes. In 1987, the system will provide care to approximately 1.3 million inpatients and approximately 18 million outpatients. Costs are escalating rapidly as the World War II veterans reach age 65 and become eligible for VA medical care without regard to financial need. In fiscal year 1984, 89 percent of VA patients were treated for nonservice-related illness or disability. According to most estimates, VA health care spending will double over the next decade unless measures to curb costs are adopted.

- Medical Care

The President's budget proposes several reforms to reduce the costs of medical care and retarget benefits more toward service-disabled veterans and those with low incomes. The proposals are detailed below.

-- Insurance Reimbursement for Medical Care - The budget proposes that insurance companies reimburse the VA for VA health care provided to insured veterans. This measure was incorporated in the conference agreement on the 1985 reconciliation legislation. The 1987 budget estimates that the VA will recover $188 million from insurance companies in fiscal year 1987 and $728 million over three years.

-- Eligibility for VA Medical Care - Top priority for VA medical care would continue to be given to veterans with service-connected disabilities. The budget proposes a means test for free VA hospital and medical care. Veterans with incomes below approximately $15,400 in 1987 for a family of two will be eligible for free VA health care on a space available basis, in addition to the following veterans:

- Former prisoners of war
- Veterans who were exposed to atomic testing or agent orange
- VA pensioners

Higher income veterans would be required to spend a certain amount for private care before they would become eligible for VA care. A similar proposal was included in the President's 1986 budget.

- Construction

The 1987 budget proposes $451 million for VA construction, which is a reduction of $187 million, or 29 percent, from the 1986 preliminary CBO baseline. The construction budget is $219 million (33 percent) below the 1987 preliminary CBO baseline. In 1987, construction funds are proposed for two large hospital projects in Augusta, GA and Baltimore, MD. The budget doubles the grants to States for State veterans home construction from $21 million to $42 million in 1987.

3. VA Housing

The Veterans Administration currently guarantees housing loans for eligible veterans up to 60 percent of the mortgage or $27,500, whichever is less, and makes direct loans under certain conditions. These programs will assist approximately 215,000 veterans in obtaining mortgages in 1987. The VA housing loan revolving fund has been running a deficit. For the first time, the volume of loan guarantees has been limited. In fiscal year 1986, as a result of the Gramm-Rudman deficit reduction legislation, that cap is $11.5 billion, with $0.5 billion of the potential guarantees being sequestered.

The budget proposes an increase in the VA housing loan origination fee from 1 to 2 percent in 1987, which is estimated by the VA to increase fiscal year 1987 receipts by $0.15 billion. The proposal would increase the fee to 3.8 percent by 1990, and generate receipts of $0.50 billion over three years.

PERSPECTIVE

The Veterans Benefits and Services function has increased by approximately 25 percent since fiscal year 1980, with outlays rising from $21.2 billion to $26.40 billion in the 1987 budget request.

Income security for veterans has kept pace with inflation as pensioners received automatic cost-of-living increases and Congress increased compensation benefits to provide protection against erosion of real benefits and provide greater equity with pensioners. Despite deficit reduction efforts, including the elimination of most COLAs in 1986, veterans compensation and pension benefits have been protected.

The estimate for readjustment benefits steadily decreases, as veterans' entitlement expires, veterans fully utilize benefits, or complete their education goals. Since fiscal year 1980, outlays have dropped by over one-half, and the trend will continue if the President's proposal to terminate the peacetime education program is adopted.

VA hospital and medical care costs have risen by over 50 percent since fiscal year 1980. The VA hospital and medical care system is being re-directed toward the needs of aging veterans in order to provide the most appropriate types of care for the influx of World War II veterans. Most of these 11 million veterans will reach age 65 during this decade and under current law will become eligible for VA medical care without regard to financial need. The budget has proposed a number of alternatives to curb the rising costs of VA hospital and medical care. The significant demand for medical and nursing home care and concomitant rising costs over the next two decades continue to be be a major multiyear budget issue.

FUNCTION 700: VETERANS BENEFITS AND SERVICES

(In billions of dollars)

	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
INCOME SECURITY												
Compensation	10.25	10.25	10.50	10.40	10.45	10.45	10.30	10.35	10.30	10.35	10.40	10.40
Proposed Legislation	...	...	...	...	...	...	0.30	0.25	...	...	0.30	0.30
Pensions	3.80	3.85	3.80	3.80	3.85	3.85	3.75	3.75	3.70	3.70	3.80	3.85
Burial	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.10	0.10
Insurance	0.90	0.45	0.95	0.70	0.95	0.65	0.95	0.70	0.95	0.70	1.00	0.70
SUBTOTAL 701	15.10	14.70	15.40	15.05	15.40	15.10	15.45	15.20	15.10	14.90	15.60	15.35
VETERANS EDUCATION, TRAINING & REHABILITATION												
Existing Law	1.20	1.10	1.00	0.65	1.00	0.65	0.90	0.65	0.90	0.65	0.80	0.55
Proposed Legislation	...	...	...	...	...	...	...	...	...	...	-0.15	*
SUBTOTAL 702	1.20	1.10	1.00	0.65	1.00	0.65	0.90	0.65	0.90	0.65	0.65	0.55
HOSPITAL AND MEDICAL CARE												
Medical Care	8.95	8.70	9.15	9.15	9.15	9.05	9.40	9.35	9.15	9.15	9.10	8.95
Proposed Legislation	...	...	...	...	...	...	...	...	...	...	-0.20	-0.20
Construction	0.80	0.55	0.65	0.55	0.65	0.60	0.65	0.55	0.65	0.60	0.45	0.70
Med. Adm; Research	0.25	0.30	0.25	0.25	0.20	0.25	0.30	0.25	0.25	0.25	0.25	0.25
SUBTOTAL 703	10.00	9.55	10.00	9.95	10.00	9.85	10.30	10.15	10.00	10.00	9.60	9.70
HOUSING (704)	0.30	0.20	0.20	0.20	0.20	0.20	0.20	0.30	0.20	0.30	...	-0.05
GENERAL OPERATING EXPENSES, OTHER (705)	0.85	0.75	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.85	0.85
TOTAL	27.40	26.35	27.40	26.60	27.40	26.60	27.70	27.10	27.00	26.65	26.70	26.40

*Less than $25 million

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 750: ADMINISTRATION OF JUSTICE

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	6.75	6.65	7.10	7.20	7.30
Outlays	6.30	6.80	6.95	7.00	7.05
CURRENT POLICY (Preliminary)					
Budget Authority	6.75	6.80	6.95	7.10	7.15
Outlays	6.30	6.75	6.90	7.10	7.25
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-0.15	+0.15	+0.10	+0.15
Outlays	...	+0.05	+0.05	-0.10	-0.20

HIGHLIGHTS

The function covers law enforcement programs under the direction of the Department of Justice as well as the Federal litigative, judicial and correctional activities. The major agencies included in this function are the Federal Bureau of Investigation, the Drug Enforcement Administration, Immigration and Naturalization Service, U.S. Customs Service, Bureau of Alcohol, Tobacco, and Firearms, Legal Services Corporation, Secret Service, and the Equal Employment Opportunity Commission. President Reagan's fiscal year 1987 budget is $0.15 billion in budget authority below and $0.05 billion in outlays above the preliminary 1987 CBO baseline for these programs.

Highlights of the major programs in this function are as follows:

- Federal Law Enforcement Activities - The 1987 budget includes a total of $3.95 billion in budget authority and $3.85 billion in outlays for the major law enforcement agencies (FBI, DEA, U.S. Customs, INS and Secret Service). The 1987 Reagan budget includes a budget authority request of $1,690 million for criminal investigations (FBI, DEA, and orgainzed crime drug activities). This is an 11 percent ($168 million) increase over the fiscal year 1986 funding level of $1,522 million and is primarily related to increased drug investigations.

- Federal Correctional Activities - The 1987 budget includes $0.75 billion in budget authority and $0.70 billion in outlays for Federal correctional activities. This is a 29 percent ($170 million) increase over the fiscal

year 1986 funding level of $588 million. The increase is primarily related to a request to construct three new medium security prisons.

- Criminal Justice Assistance - The budget includes $0.20 billion in budget authority and $0.20 billions in outlays for criminal justice assistance in 1987. This is $0.10 billion in budget authority and outlays below the preliminary 1987 CBO baseline and $0.10 billion in budget authority and $0.05 billion in outlays below the fiscal year 1986 funding level. The fiscal year 1987 reduction is related to the elimination of juvenile justice grants, State and local assistance grants, Mariel Cuban assistance, and the regional information sharing system program.

- Juvenile Justice - The 1987 budget proposes elimination of the juvenile justice programs and formula grants for an estimated savings of $67 million in budget authority from the post Gramm-Rudman fiscal year 1986 appropriation level. This is a proposal which has been included in each of the Reagan budgets.

- Legal Services Corporation (LSC) - The 1987 budget proposes the elimination of the Legal Services Corporation, a reduction of $292 million in budget authority from the post Gramm-Rudman fiscal year 1986 appropriation and $269 million in outlays from the preliminary 1987 CBO baseline. This is a proposal which has been included in each of the Reagan budgets.

MAJOR ISSUES

1. Legal Services Corporation (LCS)

For the fifth consecutive year, the budget proposes the elimination of the LSC. Congress has rejected previous requests to eliminate the LSC, appropriating $241 million in 1982 and 1983, $275 million in 1984 and $305 million in 1985 and 1986. The latter appropriation was reduced by 4.3 percent to $292 million by the fiscal year 1986 Gramm-Rudman sequestration.

2. Juvenile Justice Assistance

The budget again proposes the termination of juvenile justice assistance activities based on the rationale that the primary purpose of the program (separation of juvenile from adult offenders) has been accomplished. Congress has rejected previous administration requests to terminate this program and funded it at $70 million in fiscal year 1986, which was reduced to $67 million by the Gramm-Rudman sequestration. The juvenile justice program was reauthorized in 1984 through fiscal year 1988.

3. Immigration Reform

The 1987 budget does not include a proposal for immigration reform, but legislative action is anticipated which would make funding for immigration reform a major issue. The Senate has passed S. 1200, which CBO estimates will increase the deficit by $869 million over the five year period, fiscal years 1986-90. The

House Judiciary Committee has pending before it HR 3810, Immigration Control and Legalization Amendments Act of 1985. While it is not certain when the committee will complete action on HR 3810, it is expected to be reported to the full House before the end of this session.

PERSPECTIVES

In fiscal year 1987, function 750 would grow 4 percent in budget authority and 3 percent in outlays when compared to the 1986 level and 2 percent over the preliminary CBO 1987 baseline. Law enforcement activities represent over half of the activities funded in this function. The major focus of the administration in 1987 will be to provide additional resources to increase foreign counter-intelligence and drug enforcement activities. In addition, the budget includes a proposal to construct three new medium security prisons. As in past budget submissions, the administration continues to de-emphasize grant assistance to state and local governments in areas such as juvenile justice and legal aid.

FUNCTION 750: ADMINISTRATION OF JUSTICE

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
LAW ENFORCEMENT (751)												
FBI	1.15	1.05	1.15	1.20	1.15	1.20	1.20	1.20	1.15	1.15	1.30	1.25
Drug Enforcement (DEA)	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40
Customs Service	0.75	0.65	0.75	0.75	0.75	0.80	0.75	0.75	0.75	0.75	0.75	0.75
Immigration/Service (INS)	0.60	0.55	0.60	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.55
Secret Service	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Other	0.55	0.65	0.55	0.55	0.55	0.50	0.55	0.55	0.55	0.55	0.60	0.60
Subtotal, 751	3.70	3.55	3.70	3.70	3.65	3.70	3.75	3.75	3.70	3.70	3.95	3.85
LITIGATIVE AND JUDICIARY (752)												
Legal Services Corporation	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	...	0.05
Other	1.90	1.75	1.90	1.90	1.90	1.90	2.00	2.00	1.90	1.90	2.25	2.15
Subtotal, 752	2.20	2.05	2.20	2.20	2.20	2.20	2.30	2.30	2.20	2.20	2.25	2.20
FEDERAL CORRECTIONAL ACTIVITIES	0.60	0.55	0.60	0.60	0.60	0.65	0.55	0.60	0.55	0.60	0.75	0.70
CRIMINAL JUSTICE ASSISTANCE (754)												
Justice Assistance	0.15	0.15	0.20	0.20	0.05	0.15	0.20	0.20	0.20	0.20	0.05	0.15
Other	0.05	*	0.10	0.05	0.15	0.05	0.15	0.10	0.10	0.10	0.15	0.05
Subtotal, 754	0.20	0.15	0.30	0.25	0.20	0.20	0.35	0.30	0.30	0.30	0.20	0.20
FUNCTION TOTALS	6.75	6.30	6.80	6.75	6.65	6.80	6.95	6.90	6.75	6.80	7.10	6.95

*Less than $25 million.

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 800: General Government

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	5.95*	6.35	6.20	5.75	6.05
Outlays	5.25	6.25	6.05	5.70	6.10
CBO BASELINE (Preliminary)					
Budget Authority	5.65	5.85	5.90	6.00	6.05
Outlays	5.25	5.95	5.80	5.85	5.80
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	+0.30	+0.50	+0.30	-0.25	...
Outlays	...	+0.30	+0.25	-0.15	+0.30

* The printed budget includes an error; the actual 1985 budget authority was $5.65 billion.

HIGHLIGHTS

This function covers the overhead activities of the Federal government which include policy formulation and direction, financial management and revenue collection, construction and management of Federal civilian buildings and property, and administration of the merit personnel system. The major agencies in this function are the Congress, the White House and Executive Office of the President, the General Services Administration, the Office of Personnel Management, and most of the Treasury Department.

President Reagan's 1987 budget proposes amounts for 1987 that are $0.30 billion, or 5 percent, above the preliminary CBO baseline estimate for budget authority and $0.25 billion, or 4 percent, above the preliminary CBO estimate for outlays.

Highlights of the major programs in this function are:

- Internal Revenue Service (IRS) - The 1987 budget requests $4.10 billion in budget authority to fund IRS operations. This amount is $0.55 billion, or 16 percent, over the preliminary CBO baseline estimate of $3.55 for 1987. This increase will offset the effects of the March 1, 1986, sequestration reduction as well as fund continuing IRS initiatives to improve the processing of tax refunds and the collection of unpaid taxes. The budget also proposes legislation to impose new user fees for IRS letters of determination and private rulings. These fees are estimated to result in collections of $47 million in 1987. In addition, the budget includes a 1986 supplemental appropriation request for $340 million to offset the fiscal year 1986 effect of the sequestration reduction.

- Customs User Fees - The budget proposes legislation for new user fees to recover the costs of the Customs Service in processing common carrier passengers, private carriers, and commercial import arrivals starting in 1986. The proposed fee will result in estimated collections of $60 million in 1986, $520 million in 1987, and $1.58 billion over three years, 1987-1989.

- User Fees for Government-Sponsored Enterprises - The budget again proposes new user fees for government-sponsored enterprises which include the Federal National Mortgage Association, the Farm Credit System, the Federal Home Loan Mortgage Corporation, the Student Loan Marketing Association, and the Federal Home Loan Banks. The fees would be phased in over 5 years and would be based on the new securities issued by each enterprise. The proposed fee would result in estimated collections of $45 million in 1987 and $752 million over the next three fiscal years, 1987-1989.

- GSA Surplus Property Sales - The budget includes an increased emphasis on the sale and disposal of surplus property by GSA on behalf of Federal agencies, which have been given specific targets for the amount of property to transfer to GSA for disposal. The budget estimates offsetting collections of $578 million in 1987 and $658 million in 1988, about five times the typical annual level of surplus property disposals in recent years. Most of the receipts will be reflected in the owner-agency's budget rather than in this function.

MAJOR ISSUES

1. Internal Revenue Service

The 1987 budget requests $4.10 billion in funding for the IRS, a 16 percent increase over the preliminary CBO baseline estimate of $3.55 billion. This increase is to offset the effects of the March 1, 1986, sequestration reductions as well as to expand IRS efforts to improve tax return processing through enhanced automation and to collect a greater amount of unpaid taxes. The administration budget estimates that this will increase revenue collections by $0.9 billion in 1987 and $7.0 billion over the next three years, 1987-1989. In addition, the budget proposes new user fees for IRS letters of determination and private rulings, which will result in estimated collections of $47 million in 1987. Finally, the budget also proposes higher collection penalties resulting in an estimated $1.1 billion of additional revenues over the next three years, 1987-1989.

2. Customs Service User Fees

The Reagan budget proposes new Customs Service user fees beginning in 1986 to recover the costs of processing common carrier passengers, private carriers, and commercial import arrivals. The budget estimates collections of $60 million in 1986, $520 million in 1987, and $1.58 billion over the 1987-1989 period. These estimates are well above the estimates of $25 million in 1986, $220 million in 1987, and $715 million over the 1987-1989 period for the Customs Service fees proposed in the 1985 reconciliation bill conference report. That conference report assumed no commercial import fees and lower common carrier passenger fees than the budget proposes.

3. Government-Sponsored Enterprise User Fees

The budget proposes new user fees for 5 government-sponsored enterprises (Federal National Mortgage Association, Farm Credit System, Federal Home Loan Mortgage Corporation, Student Loan Marketing Association, and Federal Home Loan Banks). These enterprises are privately owned but Federally chartered and regulated. The amount of the fees would be phased in over five years and would be based on the amount of new securities issued by each enterprise. The budget estimates collections of $45 million in 1987 and $752 million over the next three years, 1987-1989. The Reagan administration believes that these fees will increase economic efficiency by eliminating special advantages these agencies enjoy in credit markets over similar private financial corporations as a result of their relationship to the Federal Government.

PERSPECTIVE

This function is composed predominantly of the salaries and operating expenses of policy making and central administrative agencies. Over 60 percent of the net spending in this function is the budget of the Internal Revenue Service. Since 1982, significant increases in the IRS have been proposed in Reagan budgets and accepted by Congress. These increases have gone toward tax return processing and revenue collection activities in an effort to increase tax revenues. The 1987 budget proposes another 16 percent increase in IRS funding over the CBO preliminary baseline estimate. The budget also reproposes new Customs Service user fees and fees for government-sponsored enterprises.

FUNCTION 800: GENERAL GOVERNMENT

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Subfunction 801: Legislative Branch	1.35	1.35	1.45	1.50	1.45	1.50	1.40	1.40	1.40	1.40	1.60	1.65
Subfunction 802: Executive Office of the President	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Subfunction 803:												
Internal Revenue Service	3.60	3.55	3.50	3.50	3.85	3.85	3.55	3.55	3.50	3.50	4.10	4.00
Federal Financing Bank Net Income	-0.30	-0.30	-0.15	-0.15	...	-0.20	-0.20	-0.20	-0.20	-0.20	...	-0.20
Offsetting Receipt for Social Security Administrative Expenses	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
Customs Fees	...	...	...	...	-0.05	-0.05	...	...	...	...	-0.50	-0.50
All Other Fiscal Operations	0.55	0.50	0.50	0.50	0.45	0.45	0.50	0.50	0.50	0.50	0.60	0.80
Subtotal, Subfunction 803	(3.60)	(3.50)	(3.60)	(3.60)	(4.00)	(3.80)	(3.60)	(3.60)	(3.55)	(3.55)	(3.95)	(3.85)
Subfunction 804: General Services	0.40	0.10	0.35	0.45	0.30	0.40	0.35	0.35	0.35	0.35	0.30	0.25
Subfunction 805: Central Personnel Activities	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
Subfunction 806: Other General Government	0.55	0.50	0.65	0.60	0.85	0.80	0.70	0.65	0.65	0.60	0.60	0.65
Subfunction 809: Offsetting Receipts	-0.50	-0.50	-0.45	-0.45	-0.50	-0.50	-0.45	-0.45	-0.45	-0.45	-0.55	-0.55
TOTAL	5.65*	5.25	5.85	5.95	6.35	6.25	5.90	5.80	5.75	5.70	6.20	6.05

*This is the correct actual budget authority for 1985; however, the President's budget incorrectly shows an 1985 amount of $5.95 billion.

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 850: GENERAL PURPOSE FISCAL ASSISTANCE

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	6.30	5.25	1.75	1.85	1.90
Outlays	6.35	6.25	1.75	1.85	1.90
CBO BASELINE (Preliminary)					
Budget Authority	6.30	5.85	6.60	6.65	6.70
Outlays	6.35	6.25	6.20	6.65	6.70
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-0.60	-4.85	-4.80	-4.80
Outlays	...	...	-4.45	-4.80	-4.80

HIGHLIGHTS

This function includes programs which provide broad financial assistance to State and local governments. The major program in this function is the General Revenue Sharing (GRS) program. The President's budget proposes the termination of the program when the current authorization expires at the end of fiscal year 1986. The budget also proposes the rescission of the last quarterly payment from fiscal year 1986 funds. The remainder of the function includes other general purpose fiscal assistance programs of which the major programs are: the Federal payment to the District of Columbia, forest service receipts paid to States, payment to U.S. territories, payments in lieu of taxes (PILT), and IRS and U.S. Customs Service collections for territories and Puerto Rico.

Highlights for the major programs in this area are as follows:

- General Revenue Sharing - President Reagan's 1987 budget proposes the termination of the GRS program at the end of fiscal year 1986. The current level for the program in 1986 is $4,005 million. The budget also proposes 1986 payments to rescind the final 1986 payment of $760 million under current law.

- Other General Purpose Fiscal Assistance

  1. Federal Payment to the District of Columbia (D.C.) - The budget proposes a payment of $522 million (net of loan repayments) for D.C. This proposal compares to the fiscal year 1986 level of $495 million, and the preliminary 1987 CBO baseline of $527 million.

2. Payments in Lieu of Taxes (PILT) - This program provides payments to local governments for Federal use of land located within their jurisdictions. The budget proposes fiscal year 1987 funding of $105 million which compares to the fiscal year 1986 level of $100 million and the preliminary 1987 CBO baseline level of $104 million.

3. Payments to States from Receipts Under the Mineral Leasing Act - These payments represent shared receipts with States from development of mineral resources on Federal lands. The budget proposes a net payment level of $551 million after deducting the costs of operating the program. The proposed level compares to the fiscal year 1986 current level of $532 million and the fiscal year preliminary 1987 CBO baseline of $607 million.

4. Payments to States from Forest Service Receipts - This program distributes receipts to States in which National Forests are located. The budget proposes $85 million in 1987 and includes legislation to deduct the costs of managing the land before calculating the States and counties percentage. The proposed level compares to the fiscal year 1986 current level of $218 million and the fiscal year 1987 current policy level of $252 million.

5. Payments to States and Counties from Federal Land Management Activities - This program distributes receipts for shared revenues from oil, gas, coal, timber, and grazing activities on Federal lands. The budget proposes a payment level of $59 million in 1987 with receipts to be distributed on a net of costs basis. The proposed level compares to the current level of $76 million and the fiscal year preliminary 1987 CBO baseline of $82 million.

6. U.S. Customs Service Payments to Territories and Puerto Rico - These programs provide for the distribution of payments collected by the Federal government for these jurisdictions. The budget proposes a fiscal year 1987 payment of $245 million for Puerto Rico and $108 million for the Customs Service. This compares to a fiscal year 1986 current level of $234 million for Puerto Rico and $100 million for the Customs Service and a fiscal year 1987 current policy level of $245 million for Puerto Rico and $110 million for the Customs Service.

MAJOR ISSUES

General Revenue Sharing (GRS) - The major issue in this function is the assumption that GRS will not be reauthorized in fiscal year 1987. The GRS program is $4,005 million in 1986. In addition, the the budget proposes to rescind the fourth quarter GRS payment for 1986 of $760 million which occurs in fiscal year 1987.

PERSPECTIVES

The major program in this function, GRS, constitutes almost 70 percent of the function and is proposed for termination at the end of 1986 when the current authorization expires. The proposed GRS termination along with the community assistance reductions in Function 450 would result in the community development block grant program and the proposed enterprise zone initiative as the only major Federal assistance for distressed communities.

Most of the other programs in this function are shared receipts between the Federal government and States and localities as well as the Federal payment to the District of Columbia. A key issue involving these shared receipts is the President's proposal to distribute them on a net of costs basis rather than the current gross basis of distribution.

FUNCTION 850: GENERAL PURPOSE FISCAL ASSISTANCE

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
General Revenue Sharing												
General Revenue Sharing....	4.55	4.55	4.00	4.40	3.45	4.45	4.55	4.15	4.00	4.40	...	...
Other General Purpose Fiscal Assistance												
Forest Service.....	0.25	0.25	0.20	0.20	0.25	0.20	0.25	0.25	0.20	0.20	0.10	0.10
Payments to U.S. Territories	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Payments to Puerto Rico....	0.35	0.35	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Payments in Lieu of Taxes..	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Bureau of Land Management Miscellaneous Permanent Appropriations.....	0.15	0.15	0.10	0.05	*	0.05	0.10	0.10	0.10	0.05	0.05	0.05
Minerals Management Service	0.55	0.55	0.55	0.55	0.60	0.55	0.60	0.60	0.55	0.55	0.55	0.55
Payments to the D.C.....	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
U.S. Customs Service.....	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
All Other and Rounding.....	-0.35	-0.30	-0.05	...	-0.10	-0.05	0.05	0.05	-0.05	...	...	...
TOTAL.....	6.30	6.35	5.85	6.25	5.25	6.25	6.60	6.20	5.85	6.25	1.75	1.75

*Less than $25 million.

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 900: NET INTEREST

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	129.45	142.75	148.00	145.10	136.05
Outlays	129.45	142.75	148.00	145.10	135.05
CBO BASELINE (Preliminary)					
Budget Authority	129.45	137.70	144.10	154.30	157.70
Outlays	129.45	137.70	144.10	154.30	157.70
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	+5.05	+3.90	-9.20	-21.65
Outlays	...	+5.05	+3.90	-9.20	-21.65

HIGHLIGHTS

Net Interest consists of four parts: interest paid on the (gross) public debt, including that part of the debt held by the trust funds; interest received by trust funds other than Social Security as offsetting receipts; interest received by the now off-budget Social Security OASI and DI trust funds, also as offsetting receipts; and "other interest." "Other interest" consists mainly of interest paid to the Treasury by the Federal Financing Bank and Federal agency revolving funds, which appear as offsetting receipts; it also includes, as a positive outlay, interest paid by the Treasury on taxpayer refunds. The totals shown here include both the on-budget and the off-budget components.

Net interest is projected by the administration to grow 10 percent during the current fiscal year and 4 percent in fiscal year 1987, then decline 2 percent in fiscal year 1988 and 6 percent in fiscal year 1989.

The administration's interest estimates are higher than the preliminary CBO baseline estimates in 1986 and 1987 but lower in subsequent years, partly because of differences in administration interest rates and other economic assumptions, partly because of technical estimating differences, and also reflecting the effect on deficits and debt of administration policy changes aimed at achieving Gramm-Rudman targets.

- Treasury bill rate. The administration projects three-month Treasury bill rates at 7.3 percent in calendar 1986, 6.5 percent in calendar 1987, 5.6 percent in calendar 1988, and 4.8 percent in calendar 1989. The preliminary CBO baseline estimates are 6.8, 6.7, 6.4, and 6.1 percent for the same four years.

- Financing the deficits. The administration projects that it will have to borrow from the public $204 billion in fiscal year 1986 and $142 billion in fiscal year 1987. This requirement differs slightly from the total deficits of $203 billion and $144 billion because of changes in cash and other accounts. The preliminary CBO baseline estimates assume net borrowing requirements from the public of $211 billion in fiscal year 1986 and $177 billion in fiscal year 1987.

- Debt limit. Because the statutory debt limit pertains to gross debt, including that held by U.S. government trust funds such as Social Security and Civil Service Retirement, it must be increased by more than the rise in debt held by the public. The administration projects that the trust funds will acquire $80 and $67 billion of Federal debt in fiscal years 1986 and 1987 respectively. Including other small adjustments, the debt subject to limit is projected by the administration to rise $285 billion in fiscal year 1986, to $2,108 billion, and another $209 billion in fiscal year 1987, to $2,317 billion. The current statutory limit is $2078.7 billion, which implies that the debt limit will have to be raised before the end of fiscal year 1986.

MAJOR ISSUES

No legislation is proposed affecting the net interest function as such. However, the administration net interest projection assumes all other proposals in the budget are enacted as well as assuming that the economic assumptions hold. It includes some adjustments in net interest outlays caused by changes elsewhere in the budget; the largest such adjustment is an outlay increase of $0.7 billion in fiscal year 1987 and $1.1-$1.2 billion in other years (arising from reductions in offsetting interest receipts) reflecting the proposed forgiveness of debt service payments on public housing notes. This increase in Function 900 outlays partly offsets a decrease shown in Function 600 outlays on this account.

PERSPECTIVE

Net interest was 10.4 percent of the fiscal year 1981 budget and will be 13.8 percent of the budget in 1986 according to the baseline projections. Net interest amounted to 24.0 percent of individual income tax collections in fiscal year 1981 and will consume 38.9 percent in 1986.

FUNCTION 900: NET INTEREST

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Mandatory programs:												
Interest on the public debt	179.05	179.05	193.65	193.65	196.10	196.10	205.85	205.85	n/a	n/a	206.85	206.95
Interest received trust by funds other than Social Security	-22.05	-22.05	-26.45	-26.45	-26.65	-26.65	-29.45	-29.45	n/a	n/a	-29.65	-29.65
Interest received by off-budget Social Security trust funds	-4.10	-4.10	-4.20	-4.20	-4.40	-4.40	-4.55	-4.55	n/a	n/a	-4.70	-4.70
Other interest	-23.45	-23.45	-25.35	-25.35	-22.30	-22.30	-27.75	-27.75	n/a	n/a	-24.50	-24.50
Total	129.45	129.45	137.70	137.70	142.75	142.75	144.10	144.10	n/a	n/a	148.00	148.00

n/a Not available

Note: Detail may not add to totals because of rounding.

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 920: ALLOWANCES

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	...	...	0.75	2.40	3.55
Outlays	...	...	0.75	2.35	3.50
CBO BASELINE (Preliminary)					
Budget Authority	...	...	1.00	2.80	4.75
Outlays	...	...	1.00	2.95	5.05
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...		-0.25	-0.40	-1.20
Outlays	...		-0.25	-0.60	-1.55

HIGHLIGHTS

This function traditionally includes the pay raises for civilian agencies of the Federal Government. The President's budget estimates for this function may also include amounts for contingencies and other proposals, if the proposals have costs or savings which have not been distributed by function. The Congress generally distributes all amounts except the pay raise to the appropriate budget functions. Pay raises for civilian employees of the Department of Defense are contained in Function 050: National Defense.

Highlights of the major programs in this function are:

- Civilian Agency Pay Raises--Under existing law, the President's pay adjustment proposal becomes law unless the Congress takes action to reject or modify it. For fiscal year 1986, the President, in accord with the Congressional Budget Resolution assumptions, proposed no pay increase for civilian Federal employees.

  For fiscal years 1987, 1988, and 1989, the President's budget proposes a Federal civilian pay raise of 3.0 percent, effective in January in each fiscal year.

  The current policy estimate assumes civilian pay raises effective in October of each year of 3.3 percent in fiscal year 1987; 5.8 percent in fiscal year 1988; and 5.9 percent in fiscal year 1989.

- Increased Employee/Employer Contribution to Federal Retirement Trust Funds--In keeping with his legislative proposal to increase the level of contributions to Government retirement accounts, the President's budget includes $0.35 billion in fiscal year 1987, and $0.40 billion in fiscal years 1988 and 1989 to fund the employer's share of this increase.

MAJOR ISSUES

1. Federal Pay Rates

Under current law, which provides for comparability with the private sector, the fiscal year 1987 pay raise for blue collar employees would be 15.0 percent and for white collar employees it would be 19.2 percent. Under the concept of setting the increase comparable to the annual change in private sector wages, the preliminary estimate of the pay raise is projected at 3.3 percent for fiscal year 1987, 5.8 percent for fiscal year 1988, and at 5.9 percent for fiscal year 1989.

The fact that comparability laws for setting Federal civilian wage rates have remained in effect, has not precluded the erosion of civilian employee pay and benefits during the past decade. In fact, the last time the comparability standard was met was in the fiscal year starting in October 1977. In most other years major budget savings from the spending baseline have been achieved by reducing pay raise amounts and by slipping the effective date of any pay raises ultimately recommended. These pay raise savings have generally been among the largest savings accounted for in omnibus budget reconciliation bills.

2. Increased Employee/Employer Contributions to Federal Retirement Trust Funds

The President's budget indicates that legislation will be proposed to increase contributions to the various Federal retirement systems by two percent, effective in January 1987. (For employees in the executive branch under the current Civil Service Retirement System, this would mean an increase in the contribution from seven percent to nine percent of gross salary.) While the increase is proposed on the basis that the retirement trust funds are currently underfunded, the issue arises as to whether it is equitable for the Government to schedule larger contributions from employees' salaries when the Government has failed to meet the standard that Federal pay rates keep pace with pay changes in the private sector.

PERSPECTIVES

President Reagan's fiscal year 1987 pay proposals will continue the erosion of Federal pay and benefits in real terms. During the period 1981-1986 Federal pay has continued to fall behind the private sector. As stated earlier, the comparability data calls for a 19.2 percent pay increase for Federal civilian employees just to "catch-up" to their private sector counterparts. The administration, however, has made it clear that it has no intention of meeting this comparability standard. Instead, the budget proposes pay increases of three percent per annum for the next three fiscal years. Consequently, Federal civilian employee wage scales will continue to lag behind those for equivalent jobs in the private sector. Further, even if a "catch-up" pay raise were eventually provided, there would be no compensation for the lag in pay comparability which has accumulated during the past decade.

FUNCTION 920: ALLOWANCES

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Federal Civilian Employee Pay Raise.....	...	...	...	...	...	...	1.00	1.00	...	...	0.40	0.40
Increased Employer Contribution to Federal Retirement Trust Funds....	...	...	...	...	...	...	...	...	...	...	0.35	0.35
TOTAL.....	...	...	...	...	...	...	1.00	1.00	...	...	0.75	0.75

FISCAL YEAR 1987
HIGHLIGHTS AND ISSUES

FUNCTION 950: UNDISTRIBUTED OFFSETTING RECEIPTS

(In billions of dollars)

	1985 Actual	1986 Est.	1987 Est.	1988 Est.	1989 Est.
PRESIDENT'S BUDGET					
Budget Authority	-32.75	-35.80	-38.15	-46.35	-43.80
Outlays	-32.75	-35.80	-38.15	-46.35	-43.80
CBO BASELINE (Preliminary)					
Budget Authority	-32.75	-34.75	-36.40	-39.50	-40.80
Outlays	-32.75	-34.75	-36.40	-39.50	-40.80
PRESIDENT OVER/UNDER CBO BASELINE					
Budget Authority	...	-1.05	-1.75	-6.85	-3.00
Outlays	...	-1.05	-1.75	-6.85	-3.00

HIGHLIGHTS

This function includes financial transactions that are deducted from budget authority and outlays of the Government as a whole. The three items in this function are: (1) the employer share of employee retirement programs, consisting of payments by Federal agencies to employee retirement trust funds; (2) Outer Continental Shelf (OCS) receipts; and (3) receipts from the proposed sale of major physical assets--such as CONRAIL, the Naval Petroleum Reserves, and the DOE Power Administrations. (See Function 400: Transportation, for a discussion of the CONRAIL sale issue, and Function 270: Energy, for a discussion of the Naval Petroleum Reserve and DOE Power Administration sale issues.)

Highlights of the major programs in this function are:

- OCS Lease Sales--President Reagan's 1987 budget estimates that OCS receipts will total an actual $5.55 billion in fiscal year 1985, and an estimated $5.45 billion in fiscal year 1986, and $5.30 billion in fiscal year 1987. They are substantially in agreement with CBO current policy estimates.

MAJOR ISSUES

1. Accuracy of OCS Receipt Estimates

The Reagan budget's estimates of OCS receipts are similar to those assumed in the CBO current policy baseline. However, the accuracy of any estimate depends on the planned sales being held on schedule; the estimate of receipts to be garnered from each sale; and the estimate of what oil and gas prices will be in fiscal year 1986 and beyond. If oil prices continue to fall, and the lease-sale schedule were to be delayed by lawsuits, or by administrative actions like those experienced over the past few years, it would be difficult to realize the revenue target.

PERSPECTIVES

Recent leasing history, and oil market developments, underline the uncertainty behind any estimates for OCS leasing receipts.

FUNCTION 950: UNDISTRIBUTED OFFSETTING RECEIPTS

(In billions of dollars)

Program	FY 1985 Actual		Fiscal Year 1986				Fiscal Year 1987					
			CBO Baseline (Preliminary)		President's Budget		CBO Baseline (Preliminary)		Program Level Freeze		President's Budget	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Employer Share, Employee Retirement	-27.20	-27.20	-29.65	-29.65	-29.15	-29.15	-31.05	-31.05	-31.05	-31.05	-31.65	-31.65
OCS Rents and Royalties	-5.55	-5.55	-5.10	-5.10	-5.45	-5.45	-5.35	-5.35	-5.35	-5.35	-5.30	-5.30
Sale of Major Physical Assets	...	...	...	...	-1.20	-1.20	...	...	...	...	-1.20	-1.20
TOTAL	-32.75	-32.75	-34.75	-34.75	-35.80	-35.80	-36.40	-36.40	-36.40	-36.40	-38.15	-38.15

X. REVISIONS IN FISCAL YEAR 1986 BUDGET

The President's 1987 budget includes revisions to the current 1986 budget resulting from a new economic forecast, reestimates of spending, action of the Congress, reductions that occurred as a result of P.L. 99-177, the Balanced Budget and Emergency Deficit Control Act of 1985 (see Impact of Gramm-Rudman V. A.), and proposed rescission and supplemental requests. The President's budget proposes 79 fiscal year 1986 rescissions totaling $10.3 billion in previously appropriated budget authority. Outlay reductions associated with the proposed rescissions are estimated to be $2,244 million in fiscal year 1986 and $2,914 million in fiscal year 1987.

The revised fiscal year 1986 aggregates are as follows:

(In billions of dollars)

	Original President's Budget Estimates (2/4/85)	Administration Revised Estimates(2/5/86)	Change From Prior Administration Estimates
Budget Authority	1060.00	1058.75	-1.25
Outlays	973.75	979.95	+6.20
Revenues	793.75	777.15	-16.60
Deficit	180.00	202.80	+22.80

The revised fiscal year 1986 totals for spending, revenues, and the deficit differ from the administration's original submission. In the new estimate, outlays have increased by $6.20 billion, revenues have decreased by $16.6 billion, for an increase in the deficit of $22.80 billion and a total deficit of $202.8 billion.

In addition to the revised estimates of spending and revenues, the administration proposes that Congress provide an additional $1.95 billion supplemental package for the current year for priority programs (see following summary).

Summary of Administration's Proposed Rescissions

The President's budget proposes 79 fiscal year 1986 rescissions totaling $10,309 million in previously appropriated budget authority. This is the second largest rescission package requested by this President. Outlay reductions associated with the proposed rescissions are estimated to be $2,244 million in fiscal year 1986 and $2,914 million in fiscal year 1987.

In President Reagan's first two years in office, Congress approved about 80 percent of the rescission requests, reducing appropriated amounts by more than $20 billion in fiscal years 1981 and 1982. During the first five years of the Reagan administration, 75 percent of President Reagan's rescission requests have been approved by Congress.

Total Rescissions
Fiscal Year 1981 to 1985

(In billions of dollars)

	Proposed	Approved	Percent Approved
Rescissions.....	29.9	22.3	75
Rescissions by Fiscal Year			
1981.....	16.2	14.5	90
1982.....	9.5	6.0	63
1983.....	1.6	...	0
1984.....	0.7	0.1	14
1985.....	1.9	1.7	89

The following is a list of selected major rescissions proposed in this budget. (For a complete list, see the Appendix, II-(23-45)*.

(In millions of dollars)

Program	Reduction in Budget Authority
Annual Contributions for Assisted Housing.....	4,413
General Revenue Sharing (GRS).....	760
Federal Employee Health Benefits Fund.....	600
Student Financial Assistance.....	456
Training and Employment Services.....	416
Rural Housing Insurance Fund (RHIF).....	351
Urban Mass Transportation Administration (UMTA).....	298
Vocational and Adult Education.....	210
Health Resources and Services.....	206
Urban Development Action Grants (UDAG).....	206
Higher Education.....	181
Economic Support Administration (EDA).....	101
Refugee Assistance.....	88
Appalachian Regional Commissions (ARC).....	81

Summary of President's Rescission/Defferal Message

On February 5, 1985, the President sent his formal message in compliance with the Impoundment Control Act, proposing seventy-seven new rescissions totaling $9,946 million, twenty-seven new deferrals of budget authority, and fifteen revised deferrals of budget authority totaling $22,855 million (H.R. Doc. No. 161, 99th Congress, 2nd Sess. (1986)). This is the second largest dollar amount of deferrals requested since passage of the Budget Act (the largest amount requested was in the first message of President Ford in 1975). The rescissions and deferrals reported in the President's message do not correspond with those listed in this Budget. The outlay reduction associated with the President's message is as follows:

(In millions of dollars)

	Fiscal Year	Budget Authority	OMB Outlay Estimates
RESCISSIONS	1986	-9,946	-1,867
	1987	...	-2,684
	1988	...	-725
	1989	...	-305
	1990	...	-303
	1991	...	-165
	Total	-9,946	-6,049
DEFERRALS	1986	-22,855	-604
	1987	...	-267
	1988	...	+78
	1989	...	+48
	1990	...	*
	1991	...	*
	Total	-22,855	-745

* Less than 1 million

Selected major rescissions different from those included in the President's budget are as follows:

(In billions of dollars)

Program	Reduction in Budget Authority
Urban Development Action Grants (UDAG)	220
Justice Assistance	135
Training and Employment	416
Urban Mass Transit Discretionary Grants	521
Corporation of Public Broadcasting	44
Rural Housing Insurance Fund (FFB loan asset purchase)	...
Rural Housing Insurance Fund	...

Selected deferrals requested are as follows:

(In millions of dollars)

Program	Reduction In Budget Authority
Annual Contributions for Assisted Housing	7,032
Foreign Military Credit Sales Credit	4,590
Economic Support Fund	3,158
DOD - Military Construction	1,842
FAA Facilities and Equipment (Airport and Airway Trust Fund)	1,368
Strategic Petroleum Reserve	775
Housing for the Elderly or Handicapped	600
Community Development Grants	500
Urban Development Action Grants (UDAG)	251
DOD Family Housing	222

Summary of Administration's Proposed Supplemental Appropriations

For the current fiscal year, the administration proposes approximately 67 program supplemental appropriations totaling approximately $1,937 million in budget authority and $1,455 million in outlays.

The largest supplemental appropriations are for diplomatic security ($707 million), IRS operations ($340 million), and Veteran's Compensation ($272 million).

The following is a list of selected program supplementals which have been requested. For a complete list, see the Appendix, II-(4-23).

(In millions of dollars)

Function	Program	FY 1986 Budget Authority	FY 1986 Outlays
150	Diplomatic Security	707	87
300	Forest firefighting	179	177
450	Disaster relief	250	125
500	Training and Employment Services	74	3
700	Veterans' Compensation	272	245
	Veterans' Readjustments Benefits	91	91
800	IRS Operations	340	340
	Compact of Free Association	271	241

SUMMARY OF PRESIDENT'S BUDGET

(Feb. 5, 1986)
(in billions of dollars)

	1985	1986	1987	1988	1989	1990	1991
BUDGET AUTHORITY.....	1,074.05	1,058.75	1,102.00	1,165.95	1,218.05	1,261.30	1,310.10
OUTLAYS.....	946.30	979.95	994.00	1,026.75	1,063.60	1,093.85	1,122.70
REVENUES.....	734.05	777.15	850.35	933.20	996.10	1,058.10	1,124.05
DEFICIT.....	212.25	202.80	143.65	93.55	67.50	35.75	-1.35
DEBT SUBJECT TO LIMIT.....	1,823.80	2,108.45	2,317.35	2,506.50	2,681.90	2,838.95	2,974.30
FUNCTION							
050 NATIONAL DEFENSE:							
BUDGET AUTHORITY.....	294.65	286.10	320.35	341.55	363.25	384.75	405.90
OUTLAYS.....	252.75	265.85	282.25	299.15	322.30	344.85	366.30
150 INTERNATIONAL AFFAIRS:							
BUDGET AUTHORITY.....	26.45	20.80	22.65	21.55	21.45	20.90	20.80
OUTLAYS.....	16.20	17.15	18.60	18.25	18.05	17.45	17.70
250 GENERAL SCIENCE, SPACE & TECHNOLOGY:							
BUDGET AUTHORITY.....	9.15	8.80	9.45	9.95	11.05	11.55	12.15
OUTLAYS.....	8.65	8.90	9.20	9.30	10.15	11.05	11.65
270 ENERGY:							
BUDGET AUTHORITY.....	8.75	5.80	4.35	5.35	4.80	4.65	4.70
OUTLAYS.....	5.70	4.45	4.00	4.50	3.95	3.70	3.90
300 NATURAL RESOURCES & ENVIRONMENT:							
BUDGET AUTHORITY.....	13.35	11.95	10.95	10.60	10.00	9.35	9.40
OUTLAYS.....	13.35	12.90	11.95	11.80	11.65	11.20	10.65
350 AGRICULTURE:							
BUDGET AUTHORITY.....	27.50	28.05	19.60	22.25	22.55	18.45	13.60
OUTLAYS.....	25.55	25.85	19.55	19.65	18.90	15.45	11.45
370 COMMERCE & HOUSING CREDIT:							
BUDGET AUTHORITY.....	12.10	8.75	10.20	8.70	6.50	7.65	7.05
OUTLAYS.....	4.25	3.80	1.35	3.85	-0.50	-0.95	-1.75
400 TRANSPORTATION:							
BUDGET AUTHORITY.....	29.55	27.55	22.55	22.40	22.50	22.60	22.75
OUTLAYS.....	25.85	27.10	25.50	24.10	23.40	23.75	23.05
450 COMMUNITY & REGIONAL DEVELOPMENT:							
BUDGET AUTHORITY.....	8.15	6.80	3.80	4.95	4.85	5.50	5.50
OUTLAYS.....	7.70	7.90	6.55	5.45	4.95	5.20	5.20
500 EDUCATION, TRAINING, EMPLOYMENT & SOCIAL SERVICES:							
BUDGET AUTHORITY.....	32.35	28.60	26.95	26.65	26.55	26.05	26.05
OUTLAYS.....	29.35	30.65	27.45	26.30	26.45	26.05	25.95
550 HEALTH:							
BUDGET AUTHORITY.....	33.60	35.35	35.35	36.50	38.00	39.40	40.75
OUTLAYS.....	33.55	35.65	35.00	36.65	37.95	39.35	40.70
570 MEDICARE:							
BUDGET AUTHORITY.....	71.70	86.65	82.25	89.75	98.15	105.75	112.65
OUTLAYS.....	65.80	68.65	70.25	76.05	83.00	90.50	98.35
600 INCOME SECURITY:							
BUDGET AUTHORITY.....	164.10	151.45	153.30	163.35	166.05	171.15	183.55
OUTLAYS.....	128.20	118.10	118.35	123.10	125.75	128.35	132.45

SUMMARY OF PRESIDENT'S BUDGET

(Feb. 5, 1986)
(In billions of dollars)

	1985	1986	1987	1988	1989	1990	1991
650 SOCIAL SECURITY:							
BUDGET AUTHORITY.....	199.50	199.40	227.85	259.25	283.75	309.15	330.45
OUTLAYS.....	188.60	200.05	212.20	226.05	239.95	254.75	263.50
700 VETERANS BENEFITS & SERVICES:							
BUDGET AUTHORITY.....	27.40	27.40	26.70	27.30	27.50	27.85	27.90
OUTLAYS.....	26.35	26.60	26.40	26.90	26.90	27.20	27.15
750 ADMINISTRATION OF JUSTICE:							
BUDGET AUTHORITY.....	6.75	6.65	7.10	7.20	7.30	7.40	7.50
OUTLAYS.....	6.30	6.80	6.95	7.00	7.05	7.15	7.20
800 GENERAL GOVERNMENT:							
BUDGET AUTHORITY.....	5.95	6.35	6.20	5.75	6.05	5.95	5.70
OUTLAYS.....	5.25	6.25	6.05	5.70	6.10	5.90	5.60
850 GENERAL PURPOSE FISCAL ASSISTANCE:							
BUDGET AUTHORITY.....	6.30	5.25	1.75	1.85	1.90	2.00	2.05
OUTLAYS.....	6.35	6.25	1.75	1.85	1.90	2.00	2.05
900 NET INTEREST:							
BUDGET AUTHORITY.....	129.45	142.75	148.00	145.10	136.05	125.55	115.85
OUTLAYS.....	129.45	142.75	148.00	145.10	136.05	125.55	115.85
920 ALLOWANCES:							
BUDGET AUTHORITY.....	...	...	0.75	2.40	3.55	4.75	5.95
OUTLAYS.....	...	...	0.75	2.35	3.50	4.70	5.90
950 UNDISTRIBUTED OFFSETTING RECEIPTS:							
BUDGET AUTHORITY.....	-32.75	-35.80	-38.15	-46.35	-43.80	-49.25	-50.15
OUTLAYS.....	-32.75	-35.80	-38.15	-46.35	-43.80	-49.25	-50.15

COMPARISON OF CBO BASELINE (PRELIMINARY) AND PRESIDENT'S BUDGET FY 1987-89

	CBO Baseline (Preliminary) (Jan. 28, 1986)			President's Budget (Feb. 5, 1986)			President's Budget Over/Under CBO Baseline		
	1987	1988	1989	1987	1988	1989	1987	1988	1989
BUDGET AUTHORITY	1,115.10	1,196.85	1262.75	1,102.00	1,165.95	1,218.05	-13.10	-30.90	-44.70
OUTLAYS	1,022.85	1,086.65	1138.90	994.00	1,026.75	1,063.60	-28.85	-59.90	-75.30
REVENUES	844.70	922.20	992.90	850.35	933.20	996.10	5.65	11.00	3.20
DEFICIT	178.15	164.45	146.00	143.65	93.55	67.50	-34.50	-70.90	-78.50
DEBT SUBJECT TO LIMIT	2,358.30	2,606.10	2,844.10	2,317.35	2,506.50	2,681.90	-40.95	-99.60	-162.20
FUNCTION									
050 NATIONAL DEFENSE:									
BUDGET AUTHORITY	301.05	314.80	329.60	320.35	341.55	363.25	19.30	26.75	33.65
OUTLAYS	284.20	296.35	310.95	282.25	299.15	322.30	-1.95	2.80	11.35
150 INTERNATIONAL AFFAIRS:									
BUDGET AUTHORITY	19.85	20.00	24.20	22.65	21.55	21.45	2.80	1.55	-2.75
OUTLAYS	14.90	15.05	15.20	18.60	18.25	18.05	3.70	3.20	2.85
250 GENERAL SCIENCE, SPACE & TECHNOLOGY:									
BUDGET AUTHORITY	9.25	9.70	10.15	9.45	9.95	11.05	0.20	0.25	0.90
OUTLAYS	9.05	9.40	9.85	9.20	9.30	10.15	0.15	-0.10	0.30
270 ENERGY:									
BUDGET AUTHORITY	5.25	5.15	5.55	4.35	5.35	4.80	-0.90	0.20	-0.75
OUTLAYS	5.35	5.10	4.95	4.00	4.50	3.95	-1.35	-0.60	-1.00
300 NATURAL RESOURCES & ENVIRONMENT:									
BUDGET AUTHORITY	12.95	13.35	13.75	10.95	10.60	10.00	-2.00	-2.75	-3.75
OUTLAYS	13.10	14.10	13.95	11.95	11.80	11.65	-1.15	-2.30	-2.30
350 AGRICULTURE:									
BUDGET AUTHORITY	19.85	24.40	24.40	19.60	22.25	22.55	-0.25	-2.15	-1.85
OUTLAYS	19.80	23.20	23.05	19.55	19.65	18.90	-0.25	-3.55	-4.15
370 COMMERCE & HOUSING CREDIT:									
BUDGET AUTHORITY	10.65	11.25	8.35	10.20	8.70	6.50	-0.45	-2.55	-1.85
OUTLAYS	4.90	6.00	4.00	1.35	3.85	-0.50	-3.55	-2.15	-4.50
400 TRANSPORTATION:									
BUDGET AUTHORITY	29.05	29.65	30.50	22.55	22.40	22.50	-6.50	-7.25	-8.00
OUTLAYS	27.60	27.40	27.95	25.50	24.10	23.40	-2.10	-3.30	-4.60
450 COMMUNITY & REGIONAL DEVELOPMENT:									
BUDGET AUTHORITY	7.20	7.85	8.40	3.80	4.95	4.85	-3.45	-2.90	-3.55
OUTLAYS	7.95	8.05	8.00	6.55	5.45	4.95	-1.40	-2.60	-3.05
500 EDUCATION, TRAINING, EMPLOYMENT & SOCIAL SERVICES:									
BUDGET AUTHORITY	31.75	33.05	34.45	26.95	26.65	26.55	-4.80	-6.40	-7.90
OUTLAYS	30.75	31.95	33.20	27.45	26.30	26.45	-3.30	-5.65	-6.75
550 HEALTH:									
BUDGET AUTHORITY	39.10	42.05	45.10	35.35	36.50	38.00	-3.75	-5.55	-7.10
OUTLAYS	38.55	41.50	44.55	35.00	36.65	37.95	-3.55	-4.85	-6.60
570 MEDICARE:									
BUDGET AUTHORITY	82.95	91.05	100.80	82.25	89.75	98.15	-0.70	-1.30	-2.65
OUTLAYS	76.85	86.05	96.50	70.25	76.05	83.00	-6.60	-10.00	-13.50
600 INCOME SECURITY:									
BUDGET AUTHORITY	163.95	172.25	176.55	153.30	163.35	166.05	-10.65	-8.90	-10.50
OUTLAYS	123.70	130.95	135.50	118.35	123.10	125.75	-5.35	-7.85	-9.75

COMPARISON OF CBO BASELINE (PRELIMINARY) AND PRESIDENT'S BUDGET FY 1987-89

	CBO Baseline (Preliminary) (Jan. 28, 1986)			President's Budget (Feb. 5, 1986)			President's Budget Over/Under CBO Baseline		
	1987	1988	1989	1987	1988	1989	1987	1988	1989
650 SOCIAL SECURITY:									
BUDGET AUTHORITY.....	226.55	256.65	280.80	227.85	259.25	283.75	1.30	2.60	2.95
OUTLAYS.....	211.40	226.15	241.50	212.20	226.05	239.95	0.80	-0.10	-1.55
700 VETERANS BENEFITS & SERVICES:									
BUDGET AUTHORITY.....	27.70	28.25	28.45	26.70	27.30	27.50	-1.00	-0.95	-0.95
OUTLAYS.....	27.10	27.95	28.05	26.40	26.90	26.90	-0.70	-1.05	-1.15
750 ADMINISTRATION OF JUSTICE:									
BUDGET AUTHORITY.....	6.95	7.10	7.15	7.10	7.20	7.30	0.15	0.10	0.15
OUTLAYS.....	6.90	7.10	7.25	6.95	7.00	7.05	0.05	-0.10	-0.20
800 GENERAL GOVERNMENT:									
BUDGET AUTHORITY.....	5.90	6.00	6.05	6.20	5.75	6.05	0.30	-0.25	...
OUTLAYS.....	5.80	5.85	5.80	6.05	5.70	6.10	0.25	-0.15	0.30
850 GENERAL PURPOSE FISCAL ASSISTANCE:									
BUDGET AUTHORITY.....	6.60	6.65	6.70	1.75	1.85	1.90	-4.85	-4.80	-4.80
OUTLAYS.....	6.20	6.65	6.70	1.75	1.85	1.90	-4.45	-4.80	-4.80
900 NET INTEREST:									
BUDGET AUTHORITY.....	144.10	154.30	157.70	148.00	145.10	136.05	3.90	-9.20	-21.65
OUTLAYS.....	144.10	154.30	157.70	148.00	145.10	136.05	3.90	-9.20	-21.65
920 ALLOWANCES:									
BUDGET AUTHORITY.....	1.00	2.80	4.75	0.75	2.40	3.55	-0.20	-0.40	-1.20
OUTLAYS.....	1.00	2.95	5.05	0.75	2.35	3.50	-0.25	-0.60	-1.55
950 UNDISTRIBUTED OFFSETTING RECEIPTS:									
BUDGET AUTHORITY.....	-36.40	-39.50	-40.80	-38.15	-46.35	-43.80	-1.75	-6.85	-3.00
OUTLAYS.....	-36.40	-39.50	-40.80	-38.15	-46.35	-43.80	-1.75	-6.85	-3.00

COMPARISON OF CBO BASELINE (PRELIMINARY) AND PRESIDENT'S BUDGET FY 1986

	CBO Baseline (Preliminary) (Jan. 28, 1986)	President's Budget (Feb. 5, 1986)	President over/under CBO Baseline
	1986	1986	1986
BUDGET AUTHORITY.....	1,059.80	1,058.75	-1.05
OUTLAYS.....	986.70	979.95	-6.75
REVENUES.....	777.80	777.15	-0.65
DEFICIT.....	208.90	202.80	-6.10
DEBT SUBJECT TO LIMIT.....	2,112.60	2,108.45	-4.15
FUNCTION			
050 NATIONAL DEFENSE:			
BUDGET AUTHORITY.....	286.75	286.10	-0.65
OUTLAYS.....	269.45	265.85	-3.60
150 INTERNATIONAL AFFAIRS:			
BUDGET AUTHORITY.....	19.20	20.80	1.60
OUTLAYS.....	17.10	17.15	0.05
250 GENERAL SCIENCE, SPACE & TECHNOLOGY:			
BUDGET AUTHORITY.....	8.85	8.80	-0.05
OUTLAYS.....	8.95	8.90	-0.05
270 ENERGY:			
BUDGET AUTHORITY.....	-1.25	5.80	7.05
OUTLAYS.....	4.30	4.45	0.15
300 NATURAL RESOURCES & ENVIRONMENT:			
BUDGET AUTHORITY.....	12.55	11.95	-0.60
OUTLAYS.....	12.80	12.90	0.10
350 AGRICULTURE:			
BUDGET AUTHORITY.....	30.60	28.05	-2.55
OUTLAYS.....	30.80	25.85	-4.95
370 COMMERCE & HOUSING CREDIT:			
BUDGET AUTHORITY.....	10.20	8.75	-1.45
OUTLAYS.....	4.35	3.80	-0.55
400 TRANSPORTATION:			
BUDGET AUTHORITY.....	28.00	27.55	-0.45
OUTLAYS.....	27.45	27.10	-0.35
450 COMMUNITY & REGIONAL DEVELOPMENT:			
BUDGET AUTHORITY.....	6.90	6.80	-0.10
OUTLAYS.....	8.00	7.90	-0.10
500 EDUCATION, TRAINING, EMPLOYMENT & SOCIAL SERVICES:			
BUDGET AUTHORITY.....	30.25	28.60	-1.60
OUTLAYS.....	30.75	30.65	-0.10
550 HEALTH:			
BUDGET AUTHORITY.....	36.40	35.35	-1.05
OUTLAYS.....	36.25	35.65	-0.60
570 MEDICARE:			
BUDGET AUTHORITY.....	86.60	86.65	0.05
OUTLAYS.....	69.15	68.65	-0.50
600 INCOME SECURITY:			
BUDGET AUTHORITY.....	156.55	151.45	-5.10
OUTLAYS.....	119.40	118.10	-1.30

COMPARISON OF CBO BASELINE (PRELIMINARY) AND PRESIDENT'S BUDGET FY 1986

	CBO Baseline (Preliminary) (Jan. 28, 1986)	President's Budget (Feb. 5, 1986)	President over/under CBO Baseline
	1986	1986	1986
650 SOCIAL SECURITY:			
BUDGET AUTHORITY.....	199.50	199.40	-0.10
OUTLAYS.....	199.40	200.05	0.65
700 VETERANS BENEFITS & SERVICES:			
BUDGET AUTHORITY.....	27.40	27.40	...
OUTLAYS.....	26.60	26.60	...
750 ADMINISTRATION OF JUSTICE:			
BUDGET AUTHORITY.....	6.80	6.65	-0.15
OUTLAYS.....	6.75	6.80	0.05
800 GENERAL GOVERNMENT:			
BUDGET AUTHORITY.....	5.85	6.35	0.50
OUTLAYS.....	5.95	6.25	0.30
850 GENERAL PURPOSE FISCAL ASSISTANCE:			
BUDGET AUTHORITY.....	5.85	5.25	-0.60
OUTLAYS.....	6.25	6.25	...
900 NET INTEREST:			
BUDGET AUTHORITY.....	137.70	142.75	5.05
OUTLAYS.....	137.70	142.75	5.05
920 ALLOWANCES:			
BUDGET AUTHORITY.....	...	...	...
OUTLAYS.....	...	...	...
950 UNDISTRIBUTED OFFSETTING RECEIPTS:			
BUDGET AUTHORITY.....	-34.75	-35.80	-1.05
OUTLAYS.....	-34.75	-35.80	-1.05

HISTORICAL PERSPECTIVE ON FUNCTIONAL OUTLAYS
IN FISCAL YEARS
(IN BILLIONS OF DOLLARS)

MAJOR FUNCTION	1981	1982	1983	1984	1985	CBO BASELINE (PRELIMINARY) 1986	1987	1988	1989	PRESIDENT'S BUDGET FEBRUARY 5, 1986 1986	1987	1988	1989
050 NATIONAL DEFENSE:	157.50	185.30	209.90	227.40	252.75	269.45	284.20	296.35	310.95	265.85	282.25	299.15	322.30
150 INTERNATIONAL AFFAIRS:	13.10	12.30	11.85	15.90	16.20	17.10	14.90	15.05	15.20	17.15	18.60	16.25	18.85
250 GENERAL SCIENCE, SPACE & TECHNOLOGY:	6.45	7.20	7.95	8.30	8.65	8.95	9.05	9.40	9.85	8.90	9.20	9.70	10.15
270 ENERGY:	15.15	13.55	9.35	7.10	5.70	4.30	5.35	5.10	4.95	4.45	4.00	4.50	3.95
300 NATURAL RESOURCES & ENVIRONMENT:	13.55	13.00	12.65	12.60	13.35	12.80	13.10	14.10	13.95	12.90	11.95	11.80	11.65
350 AGRICULTURE:	11.30	15.95	22.90	13.60	25.55	30.80	19.80	23.20	23.85	25.85	19.55	19.65	18.90
370 COMMERCE & HOUSING CREDIT:	8.20	6.25	6.70	6.90	4.25	4.35	4.90	6.00	4.00	3.80	1.35	3.85	-0.50
400 TRANSPORTATION:	23.40	20.65	21.35	23.65	25.85	27.45	27.60	27.40	27.95	27.10	25.50	24.10	23.40
450 COMMUNITY & REGIONAL DEVELOPMENT:	10.55	8.75	7.55	7.65	7.70	8.00	7.95	8.05	8.00	7.90	6.55	5.45	4.95
500 EDUCATION, TRAINING, EMP. & SOC. SERV.:	33.70	27.05	26.60	27.60	29.35	30.75	30.75	31.95	33.20	30.65	27.45	26.30	26.45
550 HEALTH:	26.85	27.45	28.65	30.40	33.55	36.25	38.55	41.50	44.55	35.65	35.00	36.65	37.95
570 SOCIAL SECURITY & MEDICARE:	178.75	202.55	223.30	235.75	65.80	69.15	76.85	86.85	96.50	68.65	78.25	76.85	83.00
600 INCOME SECURITY:	99.70	107.70	122.60	112.65	128.20	119.40	123.70	132.95	135.50	119.10	118.35	123.10	125.75
650 SOCIAL SECURITY:	...	...	...	...	198.60	199.40	211.40	226.15	241.50	200.05	212.20	226.05	239.95
700 VETERANS BENEFITS & SERVICES:	23.00	23.95	24.85	26	26.35	26.60	27.10	27.95	28.85	26.60	26.40	26.90	26.90
750 ADMINISTRATION OF JUSTICE:	4.75	4.70	5.10	5.65	6.30	6.75	6.90	7.10	7.25	6.80	6.95	7.00	7.05
800 GENERAL GOVERNMENT:	4.60	4.55	4.80	5.05	5.25	5.95	5.80	5.85	5.80	6.25	6.05	5.70	6.10
850 GENERAL PURPOSE FISCAL ASSISTANCE:	6.85	6.40	6.45	6.80	6.35	6.25	6.20	6.65	6.70	6.25	1.75	1.65	1.90
900 NET INTEREST:	68.75	85.00	89.75	111.05	129.45	137.70	144.10	154.30	157.70	142.75	148.00	145.10	136.05
920 ALLOWANCES:	...	...	...	...	...	...	1.00	2.95	5.05	...	0.75	2.35	3.50
950 UNDISTRIBUTED OFFSETTING RECEIPTS:	-28.05	-26.10	-34.00	-31.95	-32.75	-34.75	-36.40	-39.50	-42.80	-35.80	-38.15	-46.75	-43.80
TOTAL OUTLAYS:	678.20	745.70	808.35	851.70	946.30	986.70	1,022.85	1,086.65	1,138.90	979.95	994.00	1,026.75	1,063.60

HISTORICAL PERSPECTIVE ON FUNCTIONAL OUTLAYS
IN FISCAL YEARS
AS A PERCENT OF TOTAL BUDGET OUTLAYS

MAJOR FUNCTION	1981	1982	1983	1984	1985	CBO BASELINE (PRELIMINARY) 1986	1987	1988	1989	PRESIDENT'S BUDGET FEBRUARY 5, 1986 1986	1987	1988	1989
050 NATIONAL DEFENSE:	27.2	24.8	26.8	26.7	26.7	27.3	27.8	27.3	27.3	27.1	28.4	29.1	30.3
150 INTERNATIONAL AFFAIRS:	1.9	1.6	1.5	1.9	1.7	1.7	1.5	1.4	1.3	1.8	1.9	1.8	1.7
250 GENERAL SCIENCE, SPACE & TECHNOLOGY:	1.2	1.2	1.2	1.2	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	1.0
270 ENERGY:	2.2	1.8	1.2	0.9	0.6	0.4	0.5	0.5	0.4	0.5	0.4	0.4	0.4
300 NATURAL RESOURCES & ENVIRONMENT:	2.0	1.7	1.6	1.5	1.4	1.3	1.3	1.3	1.2	1.3	1.2	1.1	1.1
350 AGRICULTURE:	1.7	2.1	2.8	1.6	2.7	3.1	1.9	2.1	2.0	2.6	2.8	1.9	1.8
370 COMMERCE & HOUSING CREDIT:	1.2	0.8	0.8	0.8	0.4	0.4	0.5	0.6	0.4	0.4	0.1	0.4	.2
400 TRANSPORTATION:	3.5	2.8	2.6	2.8	2.7	2.8	2.7	2.5	2.5	2.8	2.7	2.3	2.2
450 COMMUNITY & REGIONAL DEVELOPMENT:	1.6	1.1	0.9	0.9	0.8	0.8	0.8	0.7	0.7	0.8	0.7	0.5	0.5
500 EDUCATION, TRAINING, EMP. & SOC. SERV.:	5.0	3.6	3.3	3.2	3.1	3.1	3.0	2.9	2.9	3.1	2.8	2.6	2.5
550 HEALTH:	4.2	3.7	3.5	3.6	3.5	3.7	3.8	3.8	3.9	3.6	3.5	3.6	3.6
570 SOCIAL SECURITY & MEDICARE:	26.4	27.2	27.6	27.7	7.8	7.8	7.5	7.9	8.5	7.8	7.1	7.4	7.8
600 INCOME SECURITY:	14.7	14.4	15.2	13.2	13.5	12.1	12.1	12.1	11.9	12.1	11.9	12.0	11.8
650 SOCIAL SECURITY:	...	...	...	...	19.9	20.2	20.7	20.8	21.2	20.4	21.3	22.0	22.6
700 VETERANS BENEFITS & SERVICES:	3.4	3.2	3.1	3.0	2.8	2.7	2.6	2.6	2.5	2.7	2.7	2.6	2.5
750 ADMINISTRATION OF JUSTICE:	0.7	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.6	0.7	0.7	0.7	0.7
800 GENERAL GOVERNMENT:	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.6	0.6	0.6	0.6
850 GENERAL PURPOSE FISCAL ASSISTANCE:	1.0	0.9	0.8	0.8	0.7	0.6	0.6	0.6	0.6	0.6	0.2	0.2	0.2
900 NET INTEREST:	10.1	11.4	11.1	13.0	13.7	14.0	14.1	14.2	13.8	14.6	14.9	14.1	12.8
920 ALLOWANCES:	...	...	...	...	...	...	0.1	0.3	0.4	...	0.1	0.2	0.3
950 UNDISTRIBUTED OFFSETTING RECEIPTS:	-4.1	-3.5	-4.2	-3.8	-3.5	-3.5	-3.6	-3.6	-3.6	-3.7	-3.8	-4.5	-4.1
TOTAL OUTLAYS:	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0